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FINANCIAL RESEARCH PROGRAM OF THE NATIONAL BUREAU OF ECONOMIC RESEARCH

Studies in Consumer Instalment Financing:
Number Two

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1. The object of the National Bureau of Economic Research is to ascertain and to present to the public important economic facts and their interpretation in a scientific and impartial manner. The Board of Directors is charged with the responsibility of ensuring that the work of the Bureau is carried on in strict conformity with this object.

2. To this end the Board of Directors shall appoint one or more Directors of Research.

3. The Director or Directors of Research shall submit to the members of the Board, or to its Executive Committee, for their formal adoption, all specific proposals concerning researches to be instituted.

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6. The results of an inquiry shall not be published except with the approval of at least a majority of the entire Board and a two-thirds majority of all those members of the Board who shall have voted on the proposal within the time fixed for the receipt of votes on the publication proposed. The limit shall be forty-five days from the date of the submission of the synopsis and manuscript of the proposed publication unless the Board extends the limit; upon the request of any member the limit may be extended for not more than thirty days.

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(Resolution of October 25, 1926, revised February 6, 1933)

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In the conduct of this and other studies under its program of research in finance the National Bureau of Economic Research has benefited from the advice and guidance of its Committee on Research in Finance. The functions of this committee are to review and supervise the specific research plans of the staff of the Financial Research Program. The membership includes:

Sales Finance Companies and Their Credit Practices

BY WILBUR C. PLUMMER AND RALPH A. YOUNG

Financial Research Program
Studies in Consumer Instalment Financing 2

NATIONAL BUREAU OF ECONOMIC RESEARCH

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Preface

THE National Bureau of Economic Research, under grants from the Association of Reserve City Bankers and the Rockefeller Foundation, inaugurated in 1938 a broad program of research in finance, of which the initial project has been a comprehensive investigation of the instalment financing of consumers. The present study of sales finance companies is the second in a series of institutional studies under this investigation, describing the important financial agencies that deal in consumer instalment credit. Other institutional studies in the series cover personal finance companies, commercial banks, industrial banking companies and government agencies operating in the field—the Federal Housing Administration and the Electric Home and Farm Authority.

The term "instalment financing" as used in this investigation designates all consumer credit that entails the payment of interest and repayment of principal in prescheduled amounts, usually in equal instalments, under a formal legal instrument providing for definite and prompt legal action in the event of debtor default on any payment. The consumer instalment financing project therefore includes both sales finance credit and cash credit extended on instalment terms, but it excludes retail charge account credit. Instalment credit extended on the security of real estate, while of great financial importance, has also been excluded from the field of study, because of its long maturities and its other special features. Thus the types of consumer instalment credit under investigation are characterized by a relatively short or inter-

mediate term of contract as well as by an instalment basis of repayment scheduled under a formal legal instrument.

Sales financing pertains to all credit extended for the instalment purchase of merchandise. This kind of financing is conducted, at least to some extent, by commercial banks and industrial banking companies, and not infrequently dealers themselves advance the credit for their customers' instalment purchases. The present study, however, is primarily concerned not with sales financing in general but with sales finance companies in particular, although the analysis of their function as credit agencies, their credit standards and experience, their terms and characteristic practices, reveals the main features of this type of credit extension, whatever the agency engaged in it.

In preparing this study we have sought the cooperation of numerous individuals and organizations, and their information, experience and suggestions have been essential to making our results accurate and complete. Some of our materials have been drawn from personal interviews and correspondence with individuals familiar with or associated with the sales finance field, others come directly from the records of firms in the business, and still others have been furnished us by public agencies.

We take pleasure in acknowledging our indebtedness to the National Credit Office, Inc., for access to material in its files; the First National Bank of Chicago, for allowing us to consult the tabulations which it has prepared on the operations of twenty-four sales finance companies from 1935 to the present; the Bureau of Business Research of the University of Illinois, for making its original compilations of the earnings and expenses of sales finance companies during 1928-37 available for our use; the Bureau of Home Economics of the United States Department of Agriculture, for preparing special tabulations of automobile purchasers,

1935-36; the Marketing Research Division of the Bureau of Foreign and Domestic Commerce, United States Department of Commerce, for giving us access to special materials assembled in connection with its annual *Retail Credit Survey*; the National Retail Credit Association, the National Retail Furniture Association and the National Retail Dry Goods Association, for sending out questionnaires to their memberships on our behalf; the Federal Trade Commission for making its study of the motor vehicle industry immediately available to us upon its release as a public document.

Sales finance companies which have helpfully responded to requests for information are the Associates Investment Company, the Commercial Credit Company, the Commercial Investment Trust Corporation, the General Electric Contracts Corporation, the General Finance Corporation, the General Motors Acceptance Corporation. We are particularly grateful to the officers of the latter company for giving us access to special tabulations of instalment financing data. We wish to acknowledge a particular debt also to the Electric Home and Farm Authority, which generously permitted us to examine its records and furnished us with special tabulations. Milan V. Ayres, Secretary and Analyst of the National Association of Sales Finance Companies, has made materials available for our use and on many questions has given us the benefit of his extensive technical knowledge of the subject. Fred V. Chew, Executive Vice President of the American Finance Conference, has provided us with studies prepared by that organization for its membership, and his assistants have answered numerous inquiries about the sales finance business.

We have benefited greatly from the counsel of many bank credit officers who have had long experience in extending bank loans to sales finance companies, and to the numerous bankers who have assisted us in many ways, particularly Ar-

thur W. Newton of the First National Bank of Chicago, we owe a special acknowledgment.

For criticisms of the manuscript and suggestions for its revision we are particularly indebted to Winfield W. Riefler of the Institute for Advanced Study, to Moses Abramovitz, Simon Kuznets and Leo Wolman of the National Bureau research staff, and also to the directors of the National Bureau. Other readers whose critical suggestions have been helpful include: Milan V. Ayres, Secretary, National Association of Sales Finance Companies; Fred V. Chew, Executive Vice President, American Finance Conference; Margaret Grobben, Consumer Credit Institute of America, Inc.; John E. Hamm, Russell Sage Foundation; M. Haddon Howell, Chase National Bank of New York City; Rolf Nugent, Russell Sage Foundation; R. W. Pitman, Morris Plan Bank of Philadelphia; R. W. Pitman, National Credit Office, Inc.; Thomas W. Rogers, Director of Research, American Finance Conference; Paul H. Young, Reserve Discount Company of St. Louis.

The preparation of this manuscript has required the assistance of many members of our staff, and the book owes much to their combined efforts.

The compilations at the National Credit Office, Inc., were made by Dickson Reck, who also wrote the initial studies dealing with procedure, competitive relations and legal regulations.

The quantitative estimates of retail instalment credit and cash loan credit were developed by Duncan Holthausen.

David Durand was in charge of the automobile repossession study, and also derived the tables on income distribution of automobile instalment buyers.

Joseph Coppock prepared the original draft of the chapter on appliance repossessions, on the basis of records of the Electric Home and Farm Authority.

The tables covering income and expenses of sales finance companies for the past ten years were prepared by Peter Franck and Dorothy Weitzel.

Elizabeth Todd assisted in the revision of the study for publication, wrote the summary of contents and was in full charge of the editing. The manuscript has benefited greatly from her careful editorial work.

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June 1, 1940

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Summary Survey

SALES finance companies are specialized financial institutions which extend instalment credit through retail dealers to consumers. The exact number of such institutions in existence today is not known but it is probably more than a thousand, and nearly all of these have been established since 1915. Their rise has been both a cause and a result of the enormous growth of retail instalment selling that has taken place in this country since the end of the World War.

SALES FINANCE COMPANIES AS CREDIT AGENCIES

The primary activity of sales finance companies is the purchase of retail instalment contracts from dealers who have made instalment sales. This type of credit is extended principally for the purchase of consumer goods, though it is used also for the purchase of such producer goods as business vehicles, agricultural implements or appliances for use in business. In addition to their retail financing, however, most companies engage also in wholesale financing, thus supplying the dealer with the funds he needs for the purchase of goods from the manufacturer; without supplementation by financing of this type instalment selling could not be carried on in its present volume. Some companies also discount open accounts receivable or engage in the business of making small loans or conduct still other types of business activity. At the end of 1937 these latter types of activities accounted for about 6 percent of the outstandings of a representative sample of sales finance companies; wholesale financing accounted for 15 percent; and the remaining 79 percent was retail financing, of which nearly seven-eighths was for automobiles.

The significance of sales finance companies in the entire retail instalment system can be only roughly estimated. In 1937 retail dealers extended nearly $4,300,000.000 in instalment credit, including finance charges, and about half of this amount appears to have been handled by sales finance companies; over $2,000,000,000 of the total was extended by motor vehicle dealers, and in this field the participation of sales finance companies was probably as high as 75 percent. The paper not handled by such companies was carried by dealers themselves or was financed through banks or other agencies.

The total amount of instalment buying in 1937 was higher, however, than these figures would suggest, for they do not include the purchases made by means of cash loans, repayable at regular intervals, which are also to be regarded as instalment credit. The principal agencies engaged in this kind of business extended in that year over $1,600,000,000 in cash loan credit (including interest or finance charges), though of course only a part of this was used for the purchase of retail commodities. If the volume of credit extended by retail dealers is reduced to $3,700,000,000—in order to allow for the probable amount of paper covering the retail purchase of producer goods—it would appear that a total of well over $5,000,000,000 in instalment credit, including cash loans, was extended to consumers in 1937.

In addition to the private agencies of retail instalment financing there is an agency of the federal government, the Electric Home and Farm Authority, which has been engaged in financing instalment sales of electric appliances since 1934. Its activities are financed from capital and surplus and from short-term bank borrowing, and it provides credit services on a somewhat more liberal basis than do the private companies. Another government agency, the Federal Housing Administration, has had an indirect connection with sales financing through its insurance of real estate "moderniza-

tion" loans made by approved financial institutions. Most of the institutions participating in this insurance arrangement have been commercial banks, but about 2 percent were sales finance companies in the building materials field. These finance companies handled about one-fourth of the total number of notes, and a little more than one-fifth of the total amount, insured by FHA during the period from August 1934 to April 1937.

ORGANIZATION AND FINANCIAL STRUCTURE

Although a few sales finance companies are organized under the partnership or individual form of business enterprise the great majority of them are corporations, some of the largest ones comprising a number of operating companies controlled by a holding company. Some companies handle only automobile paper; others accept only "diversified" business, that is, they finance instalment purchases of various articles other than automobiles, such as electric appliances, radios, furniture or industrial equipment; and some companies handle both automobile and diversified paper. Sales finance companies may be classified also according to their relationship with manufacturers. Of the companies handling passenger automobile paper only one, at present, is factory-controlled; until recently there were two others that had preferential relations with manufacturers, but these relations were terminated by consent decrees in 1938. Factory relationship is more frequent in the diversified field, but in both automobile and diversified financing there are a great many independent companies, having no affiliation with, or preference from, any particular manufacturer.

There are three sales finance companies whose operations are national in scope, and five large regional companies, each having offices in eight or more states. The remainder are known as local companies, although a few of them cover as

much as several states. At the end of 1937 the assets of the nationals were more than seven times as great as those of the regionals, and nearly nine times as great as those of forty of the largest local companies: in that year the nationals handled roughly seven-tenths of the retail and eight-tenths of the wholesale automobile credit extended by sales finance companies. Available evidence indicates, however, that since 1929 the locals have generally maintained their competitive position as well as, and in some years notably better than, the larger companies.

The extremely rapid growth of sales finance companies in this country could not have taken place if there had not been highly developed capital and credit markets which were both able and willing to make funds available to these new institutions. In the period 1924-39 equity funds averaged roughly one-third of sales finance companies' total assets—a figure that is decidedly higher than the typical capital ratio of comparable institutions such as banks and mortgage companies. Since sales finance companies seldom own physical property in any large amount the greater proportion of these equity funds was used for financing receivables. Throughout this period the national companies' proportion of equity funds to total assets was lower than that of regionals or locals, and in most years their proportion of funds borrowed to funds owned was higher—evidence of their preferred position in the national money markets. The equity fund percentages varied considerably, of course, from one year to another, and though this variation was due largely to variation in trade volume there are indications that as the business has matured it has been able to rely more than formerly on borrowed funds.

The national companies have made fairly extensive use of long-term money markets and the regionals have used this source of funds to a moderate extent, but local companies have had to rely on the short-term money markets for prac-

tically all of their borrowed funds, and for all companies short-term debt has constituted on the whole the most important source of funds, mainly because of the need for rapid expansion or contraction, in accordance with changing conditions. Banks supply the greater part of sales finance companies' short-term funds, but open-market facilities are also used to a considerable extent, especially by the larger companies. By 1937 all of the bank debt of the national companies, and practically all that of regional companies, was incurred on an unsecured basis, but four-fifths of the bank debt of local companies was secured by pledge of collateral. Available information indicates that most short-term bank credit is for 6 months, but maturity requirements range widely—from a demand basis to 24 months or longer; interest is predominantly 1½ percent but here too there is considerable variation, the rates ranging from 1 to 12 percent, with the national companies receiving the most favorable terms. On open-market borrowing terms are as favorable as, usually more favorable than, those received from banks.

A rule of thumb standard commonly applied by bankers as a test of a sales finance company's general liquidity is its theoretical ability to liquidate all debts within 6 months merely by letting its existing instalment receivables mature, and there appears to be a fairly general adherence to such a standard; many banks, however, favor a more liberal period. Leading creditor banks obtain regular reports on the contract terms that are being granted by sales finance companies, and occasionally they have been instrumental in checking what they regarded as unwise liberalization of down payment and maturity requirements.

THE MARKET FOR SALES FINANCE CREDIT

An important factor in the great expansion of retail instalment financing that took place between 1915 and 1929 was

the invention and manufacture of certain new commodities, such as the automobile and various durable electric appliances, which had a strong appeal to consumers and which manufacturers widely promoted as available on instalment terms. Also, a concurrent increase in real incomes gave consumers sufficient purchasing power to meet instalment obligations as they came due. Data available from several sources give some indication of the economic circumstances of retail instalment buyers in general, and of sales finance company customers in particular.

Estimates from an extensive survey of consumers indicate that nearly 5,900,000 non-relief families—nearly one-fourth of the total—had a net change in retail instalment debt during the year 1935-36; the proportion was greater in the Pacific region and less in the North Central. In the $1500-2500 income groups nearly one family out of three reported a net change in debt for instalment purchases, and even in the upper income brackets—$5000 or more—15 percent of the families came under this classification. The great majority of the debtor families were urban dwellers, most of them residents of large cities, though not of the great metropolitan centers. For nearly a third of the debtor families the changes in instalment debt resulted from furniture purchases, for two-fifths they resulted from purchases of electric equipment, for one-fifth from automobiles. The distribution of the volume of debt change was quite different, however: of the net dollar increase in instalment debt automobiles were responsible for almost three-fifths, electric equipment for a little less than one-third, furniture and miscellaneous purchases for the balance. The families indebted for automobiles were concentrated mainly in the $1000-4000 income levels, whereas those indebted for other commodities were concentrated mainly in the $500-2500 levels, although refrigerator debtors were relatively infrequent in the income groups below $1000.

Only 12 percent of the non-relief families having a net

change in instalment debt during 1935-36 were farm families, though farming was the principal source of income for more than twice that high a proportion of all non-relief families. Of all wage-earning non-relief families 30 percent came under the category of debtor families, as used here, and of those in other non-farm occupations, 26 percent. Among wage-earners debt frequency was above average in all income levels between $1000 and $4000, and among other non-farm occupations in the $1000-3000 levels.

These data depict the market for retail instalment credit in general. Only from two sources—a large private sales finance company and the Electric Home and Farm Authority—are figures available on the economic circumstances of sales finance company customers. The data are admittedly not wholly reliable but they may serve roughly to fill out the picture already sketched.

The figures on the private company's customers suggest that nine-tenths of sales finance company automobile customers are drawn from the $500-4000 income groups, three-fifths from the $1000-2500 groups, used-car customers, of course, having lower incomes, on the whole, than new-car buyers. These data indicate also that between 1919 and 1934 there was a conspicuous increase in the proportion of automobile instalment customers coming from lower income groups; this is probably attributable mainly to the substantial decrease in the prices of cars, both new and used. Automobile purchasers with higher incomes bought higher-priced cars and committed themselves for larger unpaid balances and higher monthly payments than did lower-income purchasers; but the ratios of these items to income, that is, the financial burden which they represented, declined consistently as income increased.

The EHFA data pertain to electric appliance customers, and they suggest that about nine-tenths of such buyers come from the $500-3000 income levels, seven-tenths from the

$1000-2500 levels. Appliance customers, like automobile customers, are concentrated less in the lower income levels, and more in the intermediate income levels, than are non-relief families in general.

The question whether there are significant differences between cash and instalment buyers in regard to economic circumstances is difficult to answer accurately, but certain suggestions as to the answer, in regard to automobile buyers, are to be found in a small random sample of family expenditure schedules for the year 1935-36. Analysis of this sample indicates that cash buyers had higher incomes, on the average, than instalment buyers—substantially higher in the case of new-car buyers. The latter were slightly older, on the average, than used-car buyers, and in both groups cash buyers were somewhat older than instalment buyers. A higher proportion of cash than of instalment buyers were families whose principal breadwinner was engaged in business pursuits; wage-earning families who bought new cars, and professional and clerical families who bought used cars, were more predominant among instalment than among cash purchasers. It is interesting to note that the families that bought new cars for cash were more preponderantly childless than any other type of buyer. Home ownership was reported by a greater proportion of cash buyers than of instalment buyers, and by a greater proportion of new-car than of used-car buyers. In general, these findings confirm the commonsense inference that the economic circumstances of families purchasing on instalment terms are generally less favorable than those of families in a position to purchase for cash, but the fact remains that the differences between cash and instalment buyers are less striking than the similarities.

From the beginning there has been considerable disagreement on the desirability of the diversion of purchasing power that is brought about by instalment selling. Proponents of the system have contended that if consumers were not mak-

ing payments on automobiles, furniture, mechanical refrigerators and the like—all useful and relatively durable commodities—they would probably be spending their odd dollars on goods and services which could give them only temporary enjoyment. Others have held that this diversion of purchasing power warps the structure of production and adversely affects standards of consumption by encouraging extravagant or unwise expenditure. The foregoing data afford some evidence for judgment as to whether the possibility of instalment credit attracts buyers who should not purchase at all, but the ultimate answer must of course remain in the realm of opinion, for statistics cannot indicate what is prudent or imprudent for a buyer to afford. The customary criticism implies also, however, that buyers are induced by instalment terms into purchasing a good of a higher price-quality class than they would otherwise feel justified in buying, and this contention can be empirically tested, though only for automobiles.

The data pertinent to this question are for the year 1935-36, and they suggest that it is only in the used-car market, where prices range widely and may mean considerable differences in quality, that the possibility of instalment credit induces people to buy higher-priced cars than those bought by cash buyers of the same income level. Among new-car buyers it appears that in no income group did instalment buyers purchase significantly higher-priced cars than cash buyers; in fact, above the $2500 income level they bought notably lower-priced cars.

CREDIT PROCEDURE AND CREDIT LOSSES

The consumer who wishes instalment credit sometimes makes his own arrangements with a bank, loan company or other source of funds, but usually he leaves this to the dealer. The dealer may finance the transaction with his own resources, or

may direct the credit to a commercial bank or industrial banking company, but at least in automobile financing he ordinarily discounts the note with a sales finance company. He determines the finance charge on the basis of a rate chart furnished him by the finance company; in determining the amount of down payment and the number of instalments he has a certain amount of leeway, but on these matters certain standards are usually stipulated by the finance company and he must stay reasonably close to them, especially in automobile transactions, if he wishes the company to accept the paper under the customary arrangement. The exact form of the legal instrument which evidences the sale and protects the finance company's interest in the collateral is determined principally by state laws, conditional sales contracts and chattel mortgages being the most common; most transactions include also a promissory note for the amount due. The investigation of the customer's credit standing is usually completed within an hour or two, or at most a day, and after the contract has been accepted the dealer endorses it, delivers it to the finance company and receives his check for the amount of the note minus the finance charge and the insurance charge, if any.

In automobile financing, insurance is practically always required, and it is usually placed by the finance company, very often through affiliated insurance companies. In diversified financing, however, insurance is less customary, and even when required it is customarily placed by the purchaser, though there is an increasing tendency for the company itself to assume the risk of loss from fire, theft and the like.

If the purchaser makes his payments with reasonable promptness the finance company makes no effort to establish personal contact with him, but if he becomes delinquent his account receives special attention, ranging from form notices to the sending out of a special representative. Delinquency in automobile financing is considerably less than in cash in-

stalment lending: among a group of leading sales finance companies retail balances over 60 days delinquent averaged, during 1935-39, only about 1 percent or less of total retail receivables outstanding. If the representative is unable to obtain prompt payment he may adjust the difficulty by arranging to have the contract extended or rewritten to allow of smaller payments, the finance company in this case either charging interest or assessing a flat charge or a new finance charge; in ordinary years, according to the experience of one large company, approximately one out of every twenty retail automobile contracts is adjusted or refinanced, and in depression years one out of every five to eight. Or the purchaser may be influenced to refinance his debt through some other institution, such as a small loan company.

If no other solution of an overly delinquent account is possible the finance company resorts to repossession of the collateral; according to the experience of a large sales finance company about three-fifths of the cases of excessive delinquency in automobile transactions eventuate in repossession, this solution occurring three to seven times more frequently among used-car than among new-car transactions. In many cases the purchaser surrenders the collateral voluntarily, but if he does not the representative takes possession by self-help or, if the purchaser resists, the finance company resorts to court action.

Not only the purchaser's but also the dealer's financial reliability is an important consideration with the finance company, partly because it may be extending him credit for his wholesale purchases, partly because he usually has some degree of liability in cases of repossession on retail transactions. His liability in such instances is determined by the "plan" governing his relations with the finance company. Under some plans the dealer endorses his customers' contracts "without recourse," and in these cases his liability usually ends when the finance company purchases the contract. Occasion-

ally a "full recourse" endorsement is required of him, usually on substandard contracts, and then he is responsible for full payment of any remaining balance. In automobile financing the greatest volume of business is conducted, however, under what is known as a repurchase agreement; under this plan too the dealer is subject to recourse for the settlement of any defaulted balance, but he is granted certain stipulated modifications of his liability. In business taken with recourse the finance company usually sets aside a "dealer's reserve" of 1 to 3 percent of the original amount of the contract; this is payable to him periodically if he has fulfilled his obligations. Diversified financing is typically conducted on a full recourse basis, though sometimes, especially in regard to refrigerator paper, the dealer's responsibility is limited, except in specified contingencies, to the span of the first four or six instalment payments.

Estimates of the average losses incurred in sales financing have only slight significance, partly because there are so many reasons for variation, partly because there are great differences of opinion as to what constitutes a loss and as to how losses and loss reserves should be handled in accounting procedure. With this reservation, however, certain partial estimates may be attempted. During 1935-39 the average retail losses sustained during each six-month interval by a group of large companies handling mainly automobile paper ranged from over ½ percent to nearly 2 percent of the retail paper liquidated during that interval. Credit losses of sales finance companies vary, of course, according to whether their retail volume is composed mainly of recourse or non-recourse business. In the period 1929-37 one large company's losses on repurchase-agreement automobile financing ranged, on new cars, from 0.02 to 0.34 percent, and on used cars from 0.25 to 1.02 percent of the total retail paper purchased during the year in which the loss paper originated. These figures pertain mainly to losses from conversion, confiscation and

collision, and to some losses arising out of contract readjustments and fraudulent deals. Losses on non-recourse transactions are of course substantially higher.

CREDIT STANDARDS AND TERMS

Dealers and sales finance companies have evolved a more or less defined set of standards which guide them in evaluating the prospective customer's ability and willingness to meet his obligations. The relative importance attached to these various standards varies from one company to another, and varies even more as between the different types of articles financed. Factors relating to collateral security, for example—such as the cash selling price, durability and resale value of the commodity purchased—are given more weight in automobile than in diversified financing, and factors relating to the customer's reliability—such as income, credit record, age and occupation, character, employment record—are typically given most emphasis in diversified financing, where there is less possibility of reselling the collateral promptly at an assured price. The size of the down payment that the customer is willing to make, and the length of time that he needs in order to repay his debt, are also important considerations, especially in automobile financing, and both these factors have to be considered in relation to the purchaser's income.

Down payment and contract length are dependent not only on what the customer will agree to but also on what the finance company will accept. In most transactions, especially in automobile financing, the down payment consists at least partly of an allowance made for a trade-in; eight out of ten new-car sales and more than six out of ten used-car sales involve trade-ins, according to the experience of one large company. In automobile financing a standard down payment of one-third of purchase price for new cars and 40 percent

of purchase price for used cars, and a standard contract length of 12 months for all cars, were decided upon in 1924. For a number of years there was substantial adherence to these standards, but in 1934, during recovery from the depression, considerably easier terms appeared, especially in metropolitan areas. In 1936 and 1937 the two trade associations in this field adopted resolutions favoring another standardization of terms—a down payment of one-third of purchase price on all cars, and a contract length of 18 months on all except used cars more than two years older than current models, on which the contract should be no more than 12 months—and these proposals have since been reaffirmed by resolution. Possibly because of this action there was a change toward more conservative terms, evident on down payments after 1936 and on contract lengths after 1937, but there is some indication of a renewed tendency toward more liberal terms since the end of 1938.

In diversified financing there have been attempts to establish standard terms for different commodities, and individual companies sometimes set up their own standard terms, but practice is in general considerably more flexible than in automobile financing. As a rule, the larger the down payment the longer the contract may run, but the down payment is typically a much lower percent of purchase price than it is for automobiles; in 1938 it averaged 10 percent for most commodities. Contract length necessarily varies widely—from 12 to 36 or perhaps even 48 or 60 months—in accordance with the amount of original cash selling price. In this field too contract terms appear to have been liberalized considerably in the years of business expansion in the middle 1930's, and here too trade associations have made an effort to establish tighter terms. Contracts financed by the Electric Home and Farm Authority have tended to be of shorter duration, and to carry larger down payments, than were charac-

teristic during the Authority's first years, but EHFA terms are still somewhat more liberal than those of private companies.

REPOSSESSION EXPERIENCE: AUTOMOBILES

Probably the commonest and most easily understandable measure of unfavorable credit experience in sales financing is the repossession ratio—the average number of repossessions per hundred articles financed. This measure gives no indication of the actual losses involved, but variation in accounting procedures and differences between recourse and non-recourse transactions make it almost impossible to arrive at accurate averages regarding losses. A body of data covering over 4,000,000 passenger-car contracts financed at retail during 1933-36 by a single large sales finance company, while not altogether typical of automobile sales financing, may be regarded as indicative of the general pattern of repossession experience in this field.

These data indicate that about half of new-car, and seven out of ten used-car, repossessions occur before four payments are made, and that nine-tenths of the former and practically all of the latter come before the tenth payment. The reason for the trade's interest in standard contract terms is evident in the pattern of the repossession ratio when related to these factors. For both new and used cars it declines sharply and consistently as down payment increases—being average or higher than average unless down payment is more than 40 percent of cash selling price. Also, it is lower on shorter contracts, though this is true only in regard to new cars. The used-car repossession ratio varies inversely with length of contract, but the reason for this is that the comparatively few customers receiving the longer contracts on used cars are selected with special care, and that contracts on the lower-priced, higher-risk used cars are conspicuously shorter than

on those that are more costly; as used-car prices increase to $500 there is a distinct tendency for repossessions to diminish.

It is difficult to analyze repossessions from the point of view of the circumstances that made it necessary for the purchaser to relinquish his car, because such circumstances are not readily susceptible of generalization. With such classifications as are possible, however, it appears that about half of all automobile repossessions are due to financial or personal reverses suffered by the purchaser, and that nearly one-third befall customers who overestimated their ability to pay, or found car upkeep too high for their income; most of the remainder appear to be caused by breach of contract on the part of the customer.

REPOSSESSION EXPERIENCE: ELECTRIC APPLIANCES

The second major field of sales finance company operations is electric appliances. On this type of financing the most complete available data on repossessions pertain to a body of about 16,000 contracts financed by the Electric Home and Farm Authority from January through June 1937. These data show that appliance repossessions and automobile repossessions have much the same general pattern, but in regard to appliances it is possible to consider the significance of a further factor—the customer's income—as a possible indicator of the likelihood of repossession.

A special tabulation of EHFA contracts financed in the first quarter of 1938 shows a pronounced tendency for the repossession ratio to decline as purchaser's monthly income increases; the ratio is less than average for the purchasers—nearly three-fifths of the total—who received over $125 a month, and decidedly worse than average for those whose monthly incomes were less than that amount. An even more significant factor than absolute income is the related one of

monthly payment in percent of monthly income; the repossession ratio is roughly twice as high when the monthly payment is 5 to 10 percent of the monthly income as it is when the payment is less than 5 percent, but this factor appears to be more important in regard to those receiving incomes of less than $125 than it is in regard to those receiving incomes higher than that.

Appliance repossessions, like those for automobiles, tend to concentrate in the early months of the span. Over a third of the total number of repossessions estimated to occur on the 1937 sample of EHFA contracts took place before three payments were made, and more than three-fourths came within ten payments; on the average about 4 payments were made before repossession, or approximately 12 percent of the total number due. And as in automobile financing the repossession ratio decreases markedly as down payment increases; this tendency appears to be irrespective of contract length, amount of note, type of appliance financed or purchaser's income.

The repossession ratio increases as the length of contract increases, but only until the contract reaches 36 months; scarcely more than one-tenth of these EHFA contracts were for more than 36 months—these being mainly for ranges and combination purchases—but the data indicate that on them the repossession ratio tended to decline as the span became longer, irrespective of either amount of note or down payment. As in regard to the similar tendency found in repossessions on used-car contracts, this finding may be partly explained by especially careful credit selection; and it may be partly explained by the fact that the great majority of those whose contracts ran 48 months or more had incomes higher than $125 a month. In general, however, it would seem that the significance of contract length in indicating the likelihood of repossession is particularly subject to misinterpretation and exaggeration.

For contracts of 24 months or less repossession experience improves conspicuously as notes become larger, but it seems probable that amount of note is not among the more significant factors that indicate the likelihood of repossession. The repossession ratio declines very clearly, however, as the dollar amount of monthly payment increases; the ratio is twice as high when monthly payments are less than $8 as it is when they are more than this amount.

Over eight-tenths of these contracts were for refrigerators, electric ranges and washing machines; the latter had the highest proportion of repossessions—10 percent of all washing machines financed—and ranges had the lowest—3 percent. This may have been because electric-range purchasers had monthly incomes averaging $158, while the incomes of those who bought washing machines averaged only $133.

FINANCE CHARGES

In used-car financing, and for some companies also in new-car financing, it is the general practice to stipulate in rate charts only the total amount of note, and its division into monthly payments, with no indication of the respective amounts to be allocated to the cost of financing service and of insurance protection; the amount of the note and the size of the monthly payments which it necessitates are stipulated separately for each original unpaid balance and each contract length. Insurance on used cars is such a variable item, even within a single territory, that it is considered impracticable to compile a schedule of exact rates to be employed as a basis for a separate statement of insurance charges. In new-car financing, however, it has since 1935 been the practice, especially of the national companies, to state the insurance charge separately, in standard territory schedules, and to compute the finance charge as a percentage rate on the insurance plus the original unpaid balance. As in used-car financing, it

is customary to state in rate charts not the amount of finance charge but only the total amount of the note and its division into monthly payments, but at least one national company now specifies charges as well as instalment payments.

The rate used in computing finance charges on new cars is usually about ½ percent a month (of the original unpaid balance plus insurance), 6 percent on a 12-month contract, but no percentage rate is mentioned either in rate charts or in sales finance company advertising. After the "6 Percent Time Payment Plan" was introduced by General Motors Acceptance Corporation, in the fall of 1935, it was widely adopted by other companies, and widely advertised as a reduction and simplification of finance charges, but the Federal Trade Commission ordered that percentage terms could not be publicized unless they referred to simple interest. The 6 percent plan involved an interest rate considerably higher than 6 percent, because the charge was figured on the full amount of the account originally financed, regardless of the fact that the account is regularly amortized by monthly payments, but the plan effected a considerable reduction in prevalent charges and made it possible for the customer to detect any overcharge that may have been added by the dealer.

The amount that the customer actually pays is not always the same as that indicated in the rate chart: sometimes the dealer inflates the quoted charge by adding a "pack" for himself; sometimes he makes an error in computation; sometimes there are deceptions or special circumstances which lead to deviations from the normal charge.

The constituent items in the total charges actually paid by the customer are primarily the finance company's provision for expenses and profit, the retail insurance premium, the dealer's reserve or bonus and sometimes also a dealer's pack. Insurance is ordinarily required by, and also placed by, the finance company, but in most cases it covers the purchaser's

as well as the company's interest; according to a large sample of automobile transactions occurring in 1936-38 insurance costs average 40 to 50 percent of the total charge on new cars, and 25 to 35 percent of that on used cars. The dealer's loss reserve (customary in recourse financing) and the dealer's bonus (allowed mainly in non-recourse financing, as a bid for business) amount to about 10 percent of the average total charge on new-car transactions, and to somewhat more on used-car transactions. The dealer's pack, which is forbidden by some companies, averages roughly 2 percent of new-car total charges, and a higher proportion in used-car transactions. The remainder of the total charge—somewhat more or less than half—is kept by the finance company for its expenses and profit. The finance company usually, however, derives some profit also from the insurance premium, either in the form of commission or in the form of dividends or income from an associated insurance company.

According to samples of automobile transactions compiled by the Federal Trade Commission, finance charges, expressed in annual percentage rates on declining credit balances, ranged in the years 1935-38 from less than 12 to nearly 20 percent on new-car transactions, the variation arising from differences in company practices and from differences in contract lengths. From an economic point of view this is the proper basis for an expression of charges, in spite of the fact that from a legal point of view sales finance company charges are not generally regarded as interest. In relation to original unpaid balance plus insurance—the basis generally used in the sales finance business—the charges on these transactions ranged from 6 to 10 percent on 12-month contracts. The charges of the factory-controlled company were consistently lower than those of the other companies during this period, and the charges of the independent companies were highest. As a result of the introduction of the 6 percent plan the

finance charges of all companies were conspicuously lower in 1938 than they had been in 1935.

On used cars financed by these companies (1936-38) charges were considerably higher than on new cars, the annual percentage rates ranging from about 18 to 37 percent for the different types of companies and the different contract lengths. When expressed in relation to original unpaid balance plus insurance the finance charge on 12-month used-car contracts ranged from nearly 13 percent (for the factory-controlled company) to 18 percent (for the independent companies).

It should be borne in mind, however, that these are average percentages, and that there is wide variation in the finance charges on individual transactions. A dealer's error in computation, an intentional overcharge of one kind or another, accounting irregularities or some other special circumstance may result in a charge that is notably higher or lower than average. Finance charges on individual 12-month transactions in the Federal Trade Commission samples ranged, in annual percentage rate, from a low of minus 8 percent to a high of 80 percent on new cars, and from a low of minus 7 percent to a high of 132 percent on used cars.

Another point to be remembered is that the finance charge, although it is in most cases separate from the insurance charge, is computed by the company on the insurance coverage which is required of the purchaser as well as on the original unpaid balance of his purchase. The cost of this insurance varies widely in different transactions—according to the type and price of car, the territory in which it is bought, the practice of the finance company (most companies provide protection at conference rates, but the factory-controlled company writes insurance at rates about one-fourth less than standard), the amount of coverage provided, and sometimes according to other circumstances of the particular transaction. Although these variations may make significant differ-

ences in the dollar amount the purchaser pays, such differences are not reflected in the rate of finance charge. The inevitable variations in the cost of insurance make it impossible, however, to express this item accurately in percentage terms for purposes of comparison. The most accurate base for a percentage expression is original cash selling price, and on this basis insurance on the Federal Trade Commission samples of 12-month contracts averaged roughly 3 percent or a little more on both new-car and used-car transactions, being somewhat lower for the factory-controlled than for the other companies. In percent of original unpaid balance plus insurance (the same base as that used for the finance charge) insurance costs are still more approximate, but on this base too they appear to have been generally lower, on the average, for the factory-controlled than for the other companies.

There are no data on the trend of automobile finance charges over a period of years but it is possible to construct indices showing relative variations of the insurance and finance charges on a single hypothetical transaction during the period 1924-38. These indices show that in the area selected (Albany, New York) combined insurance and finance charges rose sharply in 1926 and thereafter continued at a fairly even level until their abrupt fall and still more abrupt upswing in the depression years 1931-32. They have subsequently declined irregularly to levels approximating those that prevailed in the middle 1920's, in spite of the fact that since 1931 they have included a broader insurance coverage than they did before. In fact, the fraction of the combined charge that is represented by insurance shows a fairly steady increase during this period.

A significant feature of these data is that even wide swings in the index of combined charges make but a small difference in the index of gross time price (cash selling price plus insurance and finance charges). In other words, even large per-

centage changes in charges make but small percentage changes in the total price the purchaser pays, and this fact appears to have been of considerable importance in the attitude of consumers toward rate changes, and thus in the attitude of sales finance companies toward rate competition.

In diversified financing, as in automobile financing, charges are usually quoted as a dollar cost in relation to specified original unpaid balances, though for some commodities a straight ½ percent a month, figured on original unpaid balance, is usual. In diversified financing it is not customary to impose on the purchaser a special charge for insurance protection.

The quoted charges of twelve private companies and the Electric Home and Farm Authority for the years 1936-38 indicate that for all amounts of unpaid balance and for all contract lengths EHFA showed very nearly the same annual percentage rate, and that in all categories this rate was lower than that of any private company. The differential between EHFA and the private companies was considerably smaller, however, on larger balances and on longer contracts.

ABUSES IN RETAIL INSTALMENT FINANCING, AND THEIR REGULATION

For many years the retail instalment system has been attacked for ambiguous, sometimes exorbitant finance charges, and for various deceptive and misleading practices. Regulative legislation has been proposed in several states, but so far only four states—Indiana, Maine, Michigan and Wisconsin—have taken legislative action specifically regulating retail instalment financing. The Indiana law applies to the whole field of retail instalment financing, but those of the other three states apply only to motor vehicles. The Maine law is primarily a licensing act, those of Indiana and Wisconsin provide not only for licensing but also for regulation and super-

vision, and the Michigan law contains no licensing feature but provides for regulation.

There have been various attempts, however, both within and without the trade, to regulate various sales financing practices. Trade associations have devised lists of approved practices, and proposals have been studied in regard to a new uniform conditional sales act and a uniform licensing law, both such laws to apply not only to sales finance companies and retail merchants but also to any other institutions that engage in the financing of instalment sales. Also, the Federal Trade Commission has been instrumental in drafting proposals regarding fair trade practices in automobile instalment sales, although in general the trade favors self-regulation, without government participation.

A requirement that finance charges be stated in terms of simple interest—that is, as a percentage rate on the declining credit balance due—has been favored by various consumer groups and also by various state supervisory and legislative committees. Spokesmen for sales financing interests deny the desirability of this form of quotation, however, contending that it is unnecessary and inappropriate; they hold that there is a fundamental distinction between a time sale and a loan, and the courts have generally agreed that a discount transaction is not an interest transaction. No legislation thus far enacted attempts to stipulate the form in which the finance charge should be quoted to the consumer, but the Indiana, Michigan and Wisconsin laws require that the consumer be apprised in some detail regarding the various terms of the transaction, including actual insurance and the finance charge.

Only the Indiana law has attempted to set maximum legal rates of finance charge, and the constitutionality of this provision has not been finally determined. Existing legislation generally sets standard manual rates as the maximum charge for insurance, and in the last few years insurance commis-

sioners too have concerned themselves with this aspect of sales financing, issuing rulings that rates and coverages be detailed to customers. Regulation of the dealer's participation in the finance charge, through the reserve and bonus, and prohibition of the dealer's pack, are further features of existing legislation and also of proposals regarding fair trade practices and uniform licensing legislation; in regard to such dealer payments, however, the efforts of the sales finance business toward self-regulation have been complicated by problems of competition.

Abuses in regard to delinquency, refinancing and the refunding of unearned finance and insurance charges have been widely stressed, and they are dealt with specifically in the laws of Indiana and Wisconsin; also the efforts at self-regulation and the proposals for legislative and administrative regulation give considerable emphasis to provisions regarding contract adjustment.

The instalment system has been criticized for many other business practices: hasty or peremptory repossession, accompanïed by high reinstatement fees; "add-on" contracts; the requirement of extra security in the form of chattel mortgages on non-sale merchandise, endorsements of other parties, or wage assignments; and various miscellaneous deceptions and outright frauds. Abuses of these kinds are not, however, characteristic of the more reputable companies, and they have been condemned in practically all of the proposals for regulation.

A special set of problems arises in connection with insurance practices; false inflation of the insurance charge, failure to provide the insurance paid for by the customer, ambiguity as to coverage, are a serious source of criticism. Most of these insurance abuses are eliminated when there is a clear statement to the purchaser, informing him not only as to the exact cost of his insurance but also as to the insurance coverage which is provided him, and provisions

regarding such a statement are contained in most proposals for regulation. Considerable improvement has been effected in this field by the recent widespread activity of state insurance commissioners, requiring exposure of rates and coverage and stipulating proper practices in regard to finance insurance.

INCOME, EXPENSES, PROFITS

The gross earnings of sales finance companies come from retail and wholesale financing, insurance placement, small loans, factoring and rediscounting the paper of other finance companies. Retail financing, which constitutes from two-thirds to three-fourths of receivables outstanding, furnishes the bulk of gross earnings. Wholesale financing constitutes 10 to 20 percent of receivables outstanding, and a much higher proportion of volume, but it accounts for scarcely more than 5 to 10 percent of gross income. This type of business is commonly transacted at the prevailing commercial interest rate, or even less, because the sales finance companies make a practice of accommodating dealers in this regard so that they may share in the retail instalment paper which the dealers handle. Income from handling the insurance required on automobiles constitutes an important proportion of earnings, but this item varies widely among the different companies.

Gross income shows considerable variation according to the scope of a company's operations, being on the whole lowest for national companies, and lower for regionals than for locals, when expressed in percent of year-end total assets; in the years 1928-39, for these three types of companies, it averaged respectively 11, 13 and 15 percent. The reason for this variation is mainly that the national companies hold a larger proportion of new-car paper, and a larger proportion of wholesale automobile and factoring

paper, than do the locals; such transactions, since they entail a lower risk, carry lower rates of charge.

Operating expense, cost of borrowing and provision for taxes constitute the major categories of sales finance company expenses. Total expenses too are lowest for the national companies—about 6 percent of total assets, in 1937, as compared with 8 percent for the regionals and 9 for the locals. Over two-thirds of total expenses are for operating outlays, the proportion being a little lower for the national companies, and about one-fourth is for borrowing costs, this proportion being somewhat lower for the locals and still lower for the regionals. Data on the period 1928-39 indicate that for all companies the proportion of gross income required for operating expenses and taxes increased considerably in 1930-32 and thereafter declined irregularly, but —mainly because of increased provision for taxes—to levels substantially higher than those obtaining in 1928-29. On the other hand, the cost of borrowing, which declined considerably during the depression years, in relation to gross income, maintained its lower level during the expansion years that followed.

Since its beginning the business of instalment financing has been a highly profitable one, with a very low rate of failure among the companies engaged in it. In 1937 the net profit of a representative group of sales finance companies was about 4 percent of total assets, slightly higher for the nationals, slightly lower for the locals; in relation to owners' invested capital it amounted to 19 percent for the nationals, nearly 15 percent for the regionals and 14 for the locals, the variation being due largely to differences in the capital structures of the three types of companies. But in a consideration of the profitability of an entire business, profits are properly computed in percent of total capital employed, including borrowed funds. On this basis Federal Trade Commission data indicate that in 1937 average net profit was

7.9 percent for the independent sales finance companies (regionals and locals), 6.5 percent for those that were factory-preferred and 5.6 for the one under factory control.

One reason for the relatively high and relatively stable profit rates of sales finance companies is the fact that there has been for two decades an expanding market for their services. Their ability to reduce operating expenses and increase charges in periods of cyclical decline in volume is another reason. And a third is the low interest rates on borrowed funds that have prevailed during the past few years. But the profit rates that have persisted among sales finance companies cannot be wholly understood without consideration of the competitive conditions that have characterized this business.

COMPETITIVE RELATIONS

In the sales finance business competition takes forms quite different from what might be expected if the transaction were effected directly between finance company and purchaser, with no other interests to be satisfied. In fact, it is not primarily the consumer who has led the finance companies to compete with one another in regard to such matters as charges, which are presumably of paramount concern to the consumer. As a rule the latter is mainly interested in acquiring immediate possession of the commodity he is purchasing, and is ignorant of other, possibly more advantageous, credit arrangements, or even indifferent to credit possibilities other than those conveniently presented to him. Moreover, even if by shopping around he could find a finance charge, say, 15 or 20 percent less than the one offered him, he is likely, especially if he is not among the lowest income groups, to feel that his total investment is already so large that the resultant few dollars' saving is not worth the effort.

Such factors as these undoubtedly reduce the incentive of sales finance companies to engage in rate competition.

Dealers, however, have to compete strongly for consumers' business. In the automobile field the lack of standardization in the value of used cars is a special cause of retail competition, and not infrequently the dealer must make an unwise overallowance on a trade-in if he hopes to keep his customer. And he may have to allow a smaller down payment or a longer contract than he feels to be justified. This situation too is likely to be reflected in what the customer pays, for the cost of such dealer practices is partly compensated by dealer participations in the finance charge, and may be compensated also by a packed sales price for the new commodity the consumer is buying.

It is not to be denied, however, that the consumer derives some benefit from finance company competition, partly because he is learning to be more aware of comparative charges, partly because in some fields the manufacturer has an interest in the financing arrangements offered for the instalment purchase of his goods.

Manufacturer participation in retail and wholesale instalment financing has been under serious attack in the automobile field. Of the companies that finance the instalment purchase of passenger automobiles there is today only one—General Motors Acceptance Corporation—that is under factory control, none of the others having any affiliation with motor manufacturers, but formerly several other large companies were either owned by or contractually connected with factories. In 1937 about three-fourths of the total volume of automobile paper handled by sales finance companies went to the three national companies that were at that time related to automobile manufacturers. The special arrangements between manufacturer and related finance company usually provided that the latter would finance the wholesale purchases of the factory's dealers and would offer retail

purchasers a relatively low-cost plan of financing approved by the manufacturer; the latter endeavored to influence his dealers to use, and to recommend to their customers, the facilities of the related finance company. There were also specific financial arrangements under which the manufacturer paid subsidies to the finance company and the latter sometimes paid to the factory a portion of its profits.

The manufacturer's interest in the financing process has operated to keep the factory-related companies' finance charges lower, on the whole, than those of the independent companies. The latter contended, however, that if competition had been allowed free play among all finance companies charges would have been reduced at least as much as they were under the preferential system. As a result of the independents' contention that some companies' relationships with manufacturers tended to create a monopoly situation, the Department of Justice instituted legal proceedings against the manufacturers and finance companies concerned. Late in 1938 consent decrees were signed with Ford, Chrysler and their associated finance companies, providing that the dealer should be left complete freedom to patronize any finance company he chooses, and that the manufacturer shall accord equal treatment to all finance companies. General Motors refused to sign a consent decree, and in the fall of 1939 a verdict of guilty was returned against the General Motors corporate defendants; this verdict they have filed notice of intention to appeal.

In these proceedings the Department of Justice hoped to reach three objectives: elimination of any existing coercion of dealers by the manufacturers and their related finance companies; elimination of any manufacturer discrimination against independent finance companies; and elimination from purchaser payments of any excess amounts intended for undue dealer participation in the finance charge. This third objective cannot be achieved until the GMAC case is

settled, but the first two were covered in the provisions of the consent decrees.

Since the dealer, rather than the purchaser, is the focus of finance company efforts to obtain business, it is around the dealer that most competitive practices have developed. The financing of a dealer's wholesale purchases, for example, is not a profitable business, but it is engaged in as a lever for obtaining his retail business, the relatively low rate on wholesale financing being compensated by the relatively high rate on retail transactions. Some finance companies also, for the same purpose, make loans on dealers' stocks of used cars.

The development from full recourse to repurchase-agreement or partial recourse plans is another aspect of finance company competition for dealer business, and many smaller companies have gone even farther and offered the dealer complete freedom from responsibility in cases of purchaser default. Most companies, whether they purchase predominantly under the repurchase or under the non-recourse plan, buy some paper also under the alternative arrangement. At least in relatively prosperous times the two methods of purchasing paper have not such different effects on dealer losses as might be expected, but their development has been accompanied by highly competitive practices regarding dealer payments, and these have a direct bearing on the interests of the consumer.

Under the repurchase plan, and under the less frequent full recourse plan, a loss reserve is set aside for the dealer out of the finance charge, and often it is considerably in excess of what he needs to cover actual losses. The non-recourse companies, not holding the dealer responsible for losses, could not offer him this inducement of a generous loss reserve, and therefore they developed the practice of offering him an outright bonus for his business, this too provided out of the finance charge. Some dealers provide themselves with further income by arbitrarily "packing" the

finance charge. In 1936-38, according to samples collected by the Federal Trade Commission, about one-tenth of the average insurance and finance charge on new cars—and a somewhat larger fraction on used cars—went to dealers for reserve or bonus. The various dealer participations in the finance charge create a situation that is unsatisfactory for the finance company as well as for the consumer, but attempts to remedy it have met with little success.

In recent years sales finance companies have met increasing competition from other consumer credit agencies. New institutions, particularly commercial banks and industrial banking companies, have entered the sales financing field, and new rivalry has developed from alternative methods of consumer instalment financing, such as direct cash lending. Also, especially in diversified financing, the dealer himself may undertake the financing of instalment sales, thus threatening the business of all the specialized credit agencies. The extent to which the sales finance company will withstand the rivalry of these various institutional competitors is probably dependent mainly on the extent to which it excels them in having capital resources available for a specific purpose, in having an organization geared to the procedures required, and in possessing a store of experience in regard to the intricate problems of contract terms and finance charges.

1

Sales Finance Companies as Credit Agencies

DURING the period 1915 to 1929 retail instalment selling in this country experienced an enormous growth, a development that was accompanied by the rise of a new kind of financial institution in the form of the sales finance company. This new type of credit business grew to a billion-dollar size within a few years' time, and today, in volume of credit extended, it easily dominates the entire field of consumer instalment financing.

Sales finance companies may be described provisionally as specialized financial institutions which extend credit through retail dealers to consumers, thus enabling dealers to sell and consumers to buy goods on the instalment plan. In other words, sales finance companies are institutions which customarily purchase at discount the credit instruments that are given to retail dealers by their instalment-buying customers. These institutions are known variously as finance, credit, discount, trust, contract-purchasing or acceptance companies.

RISE OF SALES FINANCE COMPANIES

Before 1915 there were few companies in the United States that made a business of financing for retail dealers their open and instalment accounts receivable. Of the leading companies now identified with the business, only six date their original organization prior to that year: Bankers Commercial Corporation, first established in 1904 as Fidelity Contract Corpora-

tion to discount retail piano paper; Commercial Investment Trust Corporation and National Bond and Investment Company, both organized in 1908; Pacific Finance Corporation, dating its origin in 1910; Commercial Credit Company and Northern Finance Company, both formed in 1912. About 1915 several of the existing companies introduced instalment financing of automobile sales, and a number of new companies were organized to specialize in instalment paper originating in this field. The subsequent founding of sales finance companies was notably rapid, and within the span of twenty years many hundreds were organized.

It is not known exactly or even approximately how many companies have been established, or what annual changes in their number have taken place. Not all companies entering the business have stayed in it, and many of the companies formed have later consolidated with others. Moreover, the field of operation of sales finance companies is vaguely defined, shading off into the small loan and industrial banking businesses, and this adds to the difficulty of determining their number.

For several years a common estimate of the number of separate sales finance companies has been "more than a thousand." The National Association of Finance Companies estimated that there were 1,297 such companies in 1928 and that this number had fallen to 1,099 by January 1, 1934.[1] The Census of Business for 1935 included an enumeration of "instalment finance companies,"[2] according to which there were 2,331 "establishments" (counting units of branch systems as separate establishments) in that year. Of this number 1,386 were single-unit companies; consequently, according to this census, there were at least that many separate companies. The remaining 945 were branches, but it is not known

[1] National Association of Finance Companies, press release, April 5, 1934.
[2] This term is used by the Census of Business to designate sales finance companies.

how many separate companies owned these branches. Whatever that number was, it would be added to the 1,386 single-unit companies to obtain the total number of sales finance companies for the year 1935.

The Census of Business found that the 2,331 establishments had 18,639 full- and part-time employees, of whom 2,230 were executives and salaried corporation officers, and that for these employees the payroll for the year amounted to $30,936,866. It reported, in addition, 598 active proprietors and firm members of unincorporated businesses who devoted the major portion of their time to the business; the compensation of this group was not ascertained.[3]

Many of the existing companies devote themselves exclusively to the financing of a particular commodity. Some of them specialize in financing automobiles in general or a particular make of automobile; others specialize in financing furniture or electric appliances; and there are some which purchase paper arising from the sale of any or all kinds of goods. Some of the finance companies are subsidiaries of manufacturers, having been organized by the manufacturer to help market his product by providing necessary credit facilities.

The growth of sales finance companies and the growth of instalment selling have been closely interrelated. The selling of automobiles on the instalment plan resulted in a demand for some special agency to finance the sales, and the finance companies which were organized to supply this need furthered the growth of instalment buying by providing the necessary credit facilities for the extension of the system. Each new increase in instalment buying caused a still greater demand for the services of the finance companies, with a consequent increase in the size and number of such companies.

[3] U. S. Department of Commerce, Census of Business, 1935, *Financial Institutions Other than Banks* (January 1937) pp. 9-11.

ACTIVITIES OF SALES FINANCE COMPANIES

The procedure followed in financing instalment sales is not always the same, but some generalization is possible. When an individual buys an article on the instalment plan he is usually required to make a down payment, which may be in cash or wholly or partly in the form of a trade-in, and to sign a credit instrument for the balance plus the finance charge and in some cases insurance. This balance is payable in instalments, usually equal in amount, at equal intervals of time, ordinarily monthly but in some cases weekly, quarterly or semi-annually. The dealer, if he wishes and is able to do so, sells the contract to a finance company and thus receives cash for his goods. In some cases his responsibility for the fulfilment of the contract ends with its sale to the finance company; when the sale is made in this way the procedure is known as selling without recourse. In other cases the dealer continues to be responsible until the debt is fully paid by the purchaser; a transaction made on these conditions is known as selling with recourse.[4] In either case the collection of the instalments is in the hands of the sales finance company.

While the primary function of sales finance companies is retail financing—that is, lending, through retailers, to individual instalment purchasers—they may also engage in wholesale financing. At the present time this is an important part of the instalment system, for without it instalment selling could not be carried on in its present volume. Through wholesale financing dealers are supplied funds with which they can buy goods, and through retail financing they are enabled to sell the goods on the instalment plan. The first makes it possible for the manufacturer to be paid in cash for goods that he sells to the dealer, and the second makes

[4] There are of course many variations between recourse and non-recourse business. The entire question of loan and credit procedure is discussed more fully in Chapter 4.

it possible for the dealer to receive cash immediately for the goods he sells to his customer.

The retail financing conducted by sales finance companies pertains principally to consumer goods, but to a considerable extent it includes also producer goods. The present study is concerned only with the sales finance company as an agency extending consumer credit, but the fact that it extends also producer credit must be made clear in order to give a complete picture of its activities. The distinction between consumer goods and producer goods is highly useful, though in some cases it is hard to draw the dividing line. In general such goods as passenger automobiles, furniture and appliances for use in the home, clothing and jewelry in the possession of the user, may be thought of as consumer goods, while taxicabs, business vehicles, agricultural implements, appliances sold to small businessmen for use in their businesses rather than in their homes, may be thought of as producer goods. To the extent that sales finance companies finance the purchase of goods in the latter classification they are extending credit to producers as well as consumers.

Some companies not only finance commodity purchases, wholesale and retail, but also discount open accounts receivable or engage in the business of making small loans or conduct still other types of business activity. This diversification of activity finds expression in the membership rules of the two trade associations in the field. The National Association of Sales Finance Companies[5] will not accept new members who have more than 25 percent of their outstandings in small loans. Aside from this limitation it welcomes any company engaged in the business of purchasing instalment contracts, whether these arise from the sale of motor vehicles or from the sale of any other kind of commodity. It also accepts

[5] This is a trade association organized in 1924 as the National Association of Finance Companies. The name was changed in 1935 by the addition of the word "Sales" to indicate the predominant type of finance business conducted by the members.

companies engaged in the business of financing doctors' and dentists' bills and insurance premiums. Quite a number of its members do not engage in automobile financing. The American Finance Conference,[6] in its membership eligibility rules, provides that companies applying for membership must be engaged principally in the instalment financing of automobiles and that 50 percent of their outstanding receivables must be in the form of discount paper as contrasted with small loans. Discount paper on products other than automobiles may be included with that on automobiles in meeting the 50 percent rule.

Some fragmentary data give an indication of the relative importance of various types of business conducted by sales finance companies. It was estimated in 1933 that automobile paper (retail and wholesale) represented at that time 90 percent of the total volume of receivables purchased, though to an increasing extent sales finance companies had participated in the financing of other articles.[7] Of 788 companies included in a computation in that year, 212 did no automobile financing.[8] During the early 1930's some sales finance companies extended their activities into the small loan field, and subsequently small loan companies have increasingly extended their business to include the financing of instal-

[6] In the autumn of 1933 the National Association of Finance Companies, in an effort to curb undesirable "business buying" practices, prepared a National Recovery Administration Code. Much opposition was aroused among the "independent" companies, who claimed that the proposed code perpetuated technical practices that permitted "coercion" by the "big three" (General Motors Acceptance Corporation, Commercial Investment Trust Corporation and Commercial Credit Company). As a result they formed another trade body, the Mid-West Finance Conference, which subsequently became the American Finance Conference. Many sales finance companies are members of both the National Association of Sales Finance Companies and the American Finance Conference.

[7] Statement of R. P. Babcock, *Hearing on a Code of Fair Practices and Competition for the Finance Company Industry*, National Recovery Administration (October 26, 1933).

[8] *Ibid.*, Exhibit H, p. 12.

ment sales. Table 1 shows the distribution of the various types of business conducted by 48 sales finance companies, as of the end of 1937.

It may be said, in short, that sales finance companies are

TABLE 1

PERCENTAGE DISTRIBUTION OF OUTSTANDING RECEIVABLES OF 48 SALES FINANCE COMPANIES, YEAR-END 1937, BY TYPE OF BUSINESS REPRESENTED[a]

Type of Business	*National Companies*[b]	*Regional Companies*[c]	*Local Companies*[d]	*All Companies*
Total retail	78.6	84.9[e]	77.5	79.1
Automobile retail[f]	*63.6*	*76.7*[e]	*75.2*	*66.0*
Other retail[g]	*15.0*	*8.2*	*2.3*	*13.1*
Total wholesale	15.9	11.0	11.2	15.0
Small loans	..	..	6.0	.5
Open accounts receivable and factoring	5.4	.5	1.5	4.6
Rediscount	..	3.5	3.4	.7
Miscellaneous	.1	.1	.4	.1
TOTAL	100.0	100.0	100.0	100.0
	$1,310,816,000	$171,622,000	$143,957,000	$1,626,395,000

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market. For the few companies whose fiscal year did not end on December 31, 1937, the nearest fiscal year-end figures were used.

[b] General Motors Acceptance Corporation, Commercial Investment Trust Corporation (excluding National Surety Company) and Commercial Credit Company.

[c] Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California, Bankers Commercial Corporation and its subsidiary, Maytag Acceptance Corporation.

[d] A sample of 40, selected according to availability of data.

[e] Includes some small loans for one company.

[f] Includes commercial vehicles.

[g] Includes industrial equipment paper as well as consumer credit. For two regional companies some rediscounted paper is included.

financial middlemen serving as a link between manufacturer and dealer and between dealer and consumer, for they supply funds to move goods on a credit basis from manufacturer to retailer to consumer. They may also be thought of, with banks, as middlemen standing between original lenders and ultimate borrowers, for they obtain funds from banks and investors which, in turn, they lend to dealers and, through dealers, to individual purchasers of goods bought on the instalment plan.

QUANTITATIVE IMPORTANCE OF RETAIL INSTALMENT CREDIT

The quantitative importance of retail instalment credit in the entire credit system is suggested by the fact that its total volume in 1937, according to our estimates, was approximately $4,279,000,000 (including finance charges, and including not only consumer credit but also a certain amount of producer credit which was extended at retail). This figure measures the volume of retail instalment credit extended by retail dealers during the year, and thus indicates the maximum supply of retail paper theoretically available for purchase by sales finance companies. The average amount of retail instalment credit outstanding during the year we have estimated at approximately $3,073,000,000.

It should be emphasized that these figures do not account for all instalment financing of retail purchases. Cash loans made by various consumer instalment credit agencies are often used for the purchase of goods at retail, and therefore when a retail customer pays cash he may in actual fact be financing his purchase by an instalment loan from a personal finance company, industrial banking company, commercial bank or credit union. In cash transactions the dealer has no way of knowing whether this is the case. The figures cited

TABLE 2

DISTRIBUTION OF VOLUME AND AVERAGE OUTSTANDINGS OF RETAIL INSTALMENT CREDIT, 1937, BY TYPE OF RETAILER[a]

Type of Retailer	*Gross Credit Extended* (in millions)	*Average Outstandings* (in millions)
Motor vehicle dealers		
Passenger cars	$2,143	$1,524
Commercial cars	306	217
Furniture and household appliance stores	744	651
Department stores	441	239
Jewelry stores	85	47
"All other" stores[b]	560	395
ALL RETAILERS	4,279	3,073

[a] Complete estimates and explanation of methods used will be presented in National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38,* by Duncan Holthausen in collaboration with Malcolm Merriam and Rolf Nugent (ms. 1940). The figures include finance charges.

[b] Includes the following types of stores: automobile tire and accessory; women's specialty; men's clothing; office equipment; coal, fuel oil and wood; lumber and building material; hardware; heating and plumbing; farm implement stores.

above refer only to that part of retail instalment financing which does not involve the transfer of cash to the buyer-borrower.

Table 2 shows how various types of retailers participated in the extension of this credit. The estimates presented in the table include retail instalment credit extended for such producer goods as motor trucks, farm implements and office furniture. Allowance for these items cannot be made with exactitude. Available evidence indicates, however, that it is reasonable to assume a volume of about $3,667,000,000 for retail instalment credit extended for consumer goods, and

that the average amount of indebtedness outstanding for these goods was approximately $2,641,000,000.[9]

There are no complete data on the proportion of retail instalment credit extended through the medium of sales finance companies, and therefore this measure of sales finance company importance can be only roughly indicated. Purchases of retail automobile paper by 419 sales finance companies reporting to the United States Department of Commerce totaled $1,721,000,000 during 1937;[10] according to Milan V. Ayres, Secretary of the National Association of Sales Finance Companies, these reporting institutions accounted for about 95 percent of all automobile financing conducted by such companies.[11] This estimate would indicate that sales finance companies handled about $1,812,000,000 in retail automobile financing in 1937, or about 75 percent of the gross retail instalment paper originating in that year with motor vehicle dealers. For only one state, Wisconsin, is complete information available on the proportion of retail automobile paper handled by sales finance companies,[12] and these data indicate an even greater participation than does the estimate above. In Wisconsin, of a total automobile instalment sales volume of $48,000,000 for the year ending October 31, 1937, sales finance companies handled as much as 87 percent, split about evenly between the national and other companies; 5 of the remaining 13 percent was purchased by banks, and 8 percent was carried by automobile dealers themselves.

[9] See National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan Holthausen in collaboration with Malcolm Merriam and Rolf Nugent (ms. 1940).

[10] The Department of Commerce release refers to 456 rather than 419 companies, but with the notation that "of these organizations, 37 have discontinued automobile financing."

[11] "The Economic Function of the Sales Finance Company," National Association of Sales Finance Companies, *Time-Sales Financing*, vol. 3, no. 1 (January 1938) p. 3.

[12] Data furnished by the Division of Consumer Credit, State Banking Department, Wisconsin.

Data for estimating the proportion of other retail instalment paper handled by sales finance companies are much less adequate, but available evidence suggests, for diversified finance paper, an outside figure of 20 percent, or a volume of about $366,000,000, handled by sales finance companies in 1937.

Taken together, these estimates give a total of approximately $2,178,000,000 for the gross retail instalment credit extended through sales finance company operations in 1937, or around 51 percent of all retail instalment credit granted by retail dealers. This would mean that 49 percent of all retail instalment paper and 25 percent of automobile paper of this type was carried by dealers themselves or was financed through banks or other agencies.

For one state, Indiana, data are available showing the distribution of total retail instalment paper among the various agencies that handle it. Indiana passed a retail instalment sales act, effective July 1, 1935, which requires all agencies to be licensed that are engaged in retail instalment financing; this requirement does not, however, apply to retailers themselves, who frequently carry the notes arising out of their own sales. In the administration of the act the state's Department of Financial Institutions has obtained information which indicates how many and what kinds of institutions are engaged in retail instalment financing, and what share of the total outstandings and number of accounts is held by each kind of institution. A compilation of these data is presented in Table 3.

Although in both 1936 and 1937 banks constituted, numerically, by far the greatest proportion of all agencies engaged in retail instalment financing, they held only small percentages of total year-end outstandings and of total accounts. In all three respects, however, they showed higher than average increases between 1936 and 1937. Sales finance companies were next in importance, in number, but in busi-

TABLE 3

AGENCIES ENGAGED IN RETAIL INSTALMENT FINANCING IN INDIANA, AND PERCENTAGE DISTRIBUTION OF THEIR YEAR-END OUTSTANDINGS AND ACCOUNTS, 1936 AND 1937[a]

Type of Agency	Number of Agencies		Distribution of Outstandings[b]		Distribution of Accounts[c]		Average Size of Accounts Outstanding	
	1936	1937	1936	1937	1936	1937	1936	1937
Sales finance companies	75	71	70.0%	67.4%	64.6%	62.8%	$239	$224
Small loan companies	57	64	13.4	13.8	15.4	15.2	192	190
Banks (state and national)	193	239	7.3	8.6	7.6	8.9	213	200
Morris Plan banking companies	6	10	.7	1.0	1.8	2.2	83	100
Miscellaneous (includes public utilities and agricultural implement companies)	16	12	8.6	9.2	10.6	10.9	179	178
ALL AGENCIES	347	396	100.0	100.0	100.0	100.0	221	209

[a] Based on annual reports of the Department of Financial Institutions, state of Indiana, for the fiscal years ended June 30, 1937 (p. 178), and June 30, 1938 (pp. 166-68). These figures do not include instalment sales financed by the dealers themselves or those financed by Electric Home and Farm Authority.

[b] Total outstandings were $55,621,184 in 1936 and $63,079,553 in 1937.

[c] Total number of accounts was 251,625 in 1936 and 300,737 in 1937.

ness carried they held over two-thirds of all outstandings and nearly two-thirds of all accounts. For each of the three items they showed slight decreases from 1936 to 1937.

In studying these illuminating figures several facts should be kept in mind: first, while they are highly satisfactory from the standpoint of completeness, their coverage is restricted to the state of Indiana; second, they do not include the instalment sales financing that is carried on by retailers themselves, without being transferred to other agencies; and third, while they refer to retail sales they include sales to farmers and small business people and thus to some extent represent financing of businessmen as well as consumers.

As to the number of those who make use of retail instalment credit, we have estimated elsewhere that a minimum of 5,900,000 non-relief families had a net change in instalment debt for commodity purchases during 1935-36, or just under one-quarter of all non-relief families in the United States.[13] The number would, of course, be still larger if we could include those who incurred and paid off their instalment obligations within the year 1935-36, and there should be a still further addition for the unknown number of relief families and single individuals who carried instalment debt. It is impossible to estimate how many families and single individuals have been indebted to sales finance companies in any single year, but the number is certainly in the millions. In regard to automobiles it is known that as many as 9,400,000 new- and used-car deals were in process of collection by sales finance companies during 1937.[14] This figure

[13] See National Bureau of Economic Research, *Bulletin*, nos. 76-77, "The Statistical Pattern of Instalment Debt," by Ralph A. Young and Blanche Bernstein (October 15, 1939). See also Chapter 3, in which these data are partially summarized.

[14] This figure is based on the volume of retail automobile instalment paper of the 419 sales finance companies reporting to the United States Department of Commerce, inflated by 5 percent for omissions. On both new and used cars the average contract length was over 12 months in 1936, and therefore it is assumed that all retail instalment paper bought by these

represents the maximum number of single individuals and families that could have made use of sales finance company services in the purchase of automobiles during that year. The actual number of single individuals and families served was certainly less than this maximum, for some financed more than one car, and some cars financed were doubtless purchased by business concerns.

SALES FINANCE AND OTHER CONSUMER INSTALMENT CREDIT

As has already been indicated, sales finance credit is not the only type of consumer credit that entails the payment of finance charges and the repayment of principal in prearranged instalments. Cash loans, made by personal finance companies, industrial banking companies, personal loan departments of commercial banks, and credit unions (and in some cases by sales finance companies themselves), also involve instalment payments. The cash obtained in this way may be, though is not necessarily, used for the purchase of retail commodities. The present study is not concerned with this type of financing, but its scope and its main differences from sales financing should be outlined briefly.

Table 4 shows the way in which cash loan financing was distributed in 1937 among the principal agencies that engage in this kind of business. The total volume of cash loan credit which they extended in that year (including interest or finance charges, and including loans insured by the Federal Housing Administration under the provisions of Title

companies in 1936 was outstanding in 1937. For 1935 it is estimated that new- and used-car contracts averaged respectively 16 and 13 months duration. Since consumers make their first payments the month after purchase, this means that sales finance companies held 1935 new- and used-car paper 17 months and 14 months respectively. Therefore on new cars the volume for the last four months of 1935 is included, but on used cars only the volume for December 1935. No adjustments are made for repossessions or for prepayment of contracts.

I) was $1,616,000,000, and their average outstandings on such loans amounted to $1,033,000,000. Thus in 1937 the whole volume of consumer instalment credit was about 3¼ times the amount of instalment credit extended in the form of cash

TABLE 4

DISTRIBUTION OF VOLUME AND AVERAGE OUTSTANDINGS OF CASH LOAN INSTALMENT CREDIT, 1937, BY TYPE OF LENDER[a]

Type of Lender	*Gross Credit Extended* (in millions)	*Average Outstandings* (in millions)
Personal finance companies[b]	$ 701	$ 361
Industrial banking companies	409	207
Commercial banks (personal loan departments)	306	179
Credit unions	148	79
All lenders, FHA Title I loans[c]	52	207
ALL LENDERS[d]	1,616	1,033
Total cash loan instalment credit	1,616	1,033
Total retail instalment credit for consumer goods	3,667	2,641
TOTAL CONSUMER INSTALMENT CREDIT	5,283	3,674

[a] Complete estimates and explanation of methods used will be presented in National Bureau of Economic Research (Financial Research Program), *The Volume of Consumer Instalment Credit, 1929-38*, by Duncan Holthausen in collaboration with Malcolm Merriam and Rolf Nugent (ms. 1940).

[b] To make the gross credit extended and average outstandings estimates comparable for all agencies, we have added to the figures for personal finance companies the estimated interest due and to become due, using methods described in National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (1940) Chapter 1. Without this item the figures for personal finance companies are $615,000,000 gross credit extended and $317,000,000 average outstandings.

[c] Notes under $2000 insured by Federal Housing Administration.

[d] These totals do not include loans extended by unregulated lenders. Such lenders are situated mainly in states that have no adequate small loan laws, and estimates concerning them are necessarily only crude approximations. With this reservation the gross credit extended by them in 1937 may be estimated at $175,000,000 and their average outstandings for the year at $90,000,000.

loans, and average outstandings on all consumer instalment credit were over 3½ times the average cash loan outstandings.

In sales financing, credit is extended for the purchase of a specific commodity or service, in the manner and under the conditions already explained in general and subsequently to be described in more detail. The buyer-borrower receives no cash; he simply obtains a particular commodity or service by means of a loan. In the granting of cash loans, however, there is a transfer of cash, which may be used to pay off old sales finance loans or to retire old cash loans or to purchase new goods or services either now or later. Regardless of the use to which the funds are put, the loans are in cash and are not directly associated with a selling-lending, buying-borrowing transaction, as are sales finance loans.

In the typical sales finance transaction the commodity is the collateral or physical security for the loan, and upon default of payment the seller-lender has the right to seize and resell the commodity. In the extension of cash credit the lender is protected in other ways. Personal finance companies, as a rule, take a chattel mortgage on household goods which are not otherwise related to the loan in any way. Industrial and Morris Plan banking companies and personal loan departments of commercial banks frequently require endorsers or comakers. All these types of cash lenders, however, make unsecured loans and loans with other types of security.

Sales finance companies, as a rule, do not negotiate loans directly with borrowers, as do cash-lending agencies, but lend indirectly by discounting notes from instalment sales. If the retail dealer himself holds the notes, he is the lender, and in this case the loan is negotiated directly between lender and borrower. When he discounts the note, however, the sales finance company is the lender, even though it has had no personal contact with the buyer-borrower; since the finance company collects the instalments—and if necessary handles the questions arising from delinquency—it has a di-

rect relationship with the consumer *after* the loan has been negotiated.

There is an important legal difference between sales finance and cash loan credit. Charges for the former, according to judicial interpretation, are exempt from laws regulating rates of interest. This distinction is based on the theory that the finance charge is not interest but is part of the selling price of the commodity. Also, sales finance agencies are relatively free from government regulation, quite in contrast with licensed small loan companies, whose activities are regulated in detail.

There are differences between sales finance and cash-lending agencies in the methods of stating charges. The sales finance company provides the dealer with a schedule of charges to be used by him in transactions with consumers. In general it expresses its charges as a flat dollar amount, roughly proportionate to the amount financed. This is in contrast with personal finance companies, which typically state their charges as so many percent per month on the unpaid monthly balance. Sales finance company practice is different also from that of industrial banking companies and personal loan departments of commercial banks, which usually state their charges on a flat percentage basis, plus incidental fees.

As has been mentioned, some sales finance companies engage in cash lending. In cases of delinquency on instalment sales contracts, when the debtor is in temporary financial difficulty but has a substantial interest in the commodity, it is frequently advantageous, both to the sales finance company and to its debtor, to refinance the debt by drawing a new contract running for a longer term and providing for smaller payments. It is the opinion of some that when a new contract of this kind is drawn the transaction becomes, like a cash loan, subject to statutory interest provisions. Some companies, however, do not make this distinction, and as-

sess a new finance charge comparable to the original one.[15] The cash-lending activities of sales finance companies are usually carried on through affiliates licensed under the small loan laws, but some sales finance companies do their refinancing through industrial banking affiliates.[16]

An examination of the financial statements of 24 leading sales finance companies for the six-month period ending June 30, 1938, made by the First National Bank of Chicago, shows that of this number 13 engaged in making small loans. The small loan business of these companies, expressed as percentages of their total volume of business, ranged from a low of 0.1 to a high of 52. The concern showing the latter percentage may be classified quite properly either as a sales finance or as a small loan company, since approximately half its volume was in the field of sales financing and the other half in small loans.

GOVERNMENT AGENCIES IN THE SALES FINANCE FIELD[17]

In addition to the private agencies of instalment financing there is an agency of the federal government, the Electric Home and Farm Authority (EHFA), which has been engaged in financing instalment sales of electric appliances since 1934. It was organized as a coordinate agency with the Tennessee Valley Authority and the Rural Electrification Administration, and it employs the instalment financing technique in "developing and fostering an increased use of

[15] For a description of statutory and administrative rulings on this issue see Chapter 9.

[16] Of the 37 offices in Pennsylvania licensed, as of September 1939, under the Consumer Discount Company Act (industrial banking act), 18 were conducted by the Bancontract Discount Company, an affiliate of the Commercial Investment Trust Corporation, organized especially to handle that company's refinancing.

[17] For a detailed discussion of these agencies see National Bureau of Economic Research (Financial Research Program), *Government Agencies of Consumer Instalment Credit*, by Joseph D. Coppock (ms. 1940).

electric power through the double reduction of cost of electricity to the consumer and the cost of electrical appliances."[18] In August 1935 it was reorganized as a District of Columbia corporation and established as an independent federal credit agency, its services being made available through any utility accepting its facilities, provided, however, that the residential electric rates of that utility conform to the standards of reasonableness held by the Authority. Aside from its federal ownership, its requirement that residential electric rates of cooperating utilities be reasonable, and its responsibility as a public agency to furnish its financing services to retail appliance purchasers at the lowest charge compatible with expense, it functions very much like any private sales finance company.

Since EHFA provides its credit services on a comparatively liberal basis the mechanics of its plan are of some interest. After the purchaser has filled out a sales finance contract, and made the required down payment to an accredited dealer, the latter sends the contract, with his endorsement, to the cooperating utility, which in turn forwards it for acceptance to EHFA. If the contract is approved and acquired by EHFA the dealer is paid the amount of the credit advance and the utility then makes the monthly collections from the purchaser, receiving in return for its service a booking payment of $1 per contract and a fee of 12½ cents per instalment collection. The utility reports delinquent customers to the Authority, and cooperates with the latter's field representative and with the dealer in handling delinquent accounts.

EHFA activities are financed from capital and surplus ($902,000 at the middle of 1938) and from short-term bank borrowing. Over the first four years of the Authority's existence (June 1, 1934, to June 30, 1938) it purchased 74,095 contracts, having a face value totaling $11,640,000, an average

[18] Electric Home and Farm Authority, Bulletin C-1 (1935).

of $157 per contract. A total of 59,181 contracts, four-fifths of all contracts purchased, were outstanding on June 30, 1938, the unpaid balances on which amounted to $6,755,000, or $114 per contract.

Mention has already been made of the Federal Housing Administration (FHA), in connection with cash lending. In pointing out the relationship between this organization and sales finance companies, still another phase of the latter's activity will be mentioned—the financing of betterments on improved real estate. In the general examination of consumer instalment financing, of which the present study is a part, consumer real estate financing involving mortgage security is not considered, but reference must be made to instalment credit that is employed in making improvements on existing real property because, to a limited extent, it is one of the activities of sales finance companies.

Under Title I of the National Housing Act of 1934 provision was made for the insurance of "modernization" loans or credit advances made by approved financial institutions, including sales finance companies. Most of the insured notes arose from cash instalment loans by commercial banks, but the plan permitted the insurance of credit advanced on sales finance instalment contracts. The insurance is designed to stimulate an increase in the flow of loanable funds to small income receivers not prepared to offer typical collateral as security. Approved financial institutions are insured against losses of as much as 10 percent (20 percent before April 1936) of the total of their insured loans. A special kind of insurance available since April 1936 is the "catastrophe loan insurance," designed to make it easier for small borrowers to secure funds for the repair of their properties after natural disasters, but little use has been made of it. The regular modernization (non-catastrophe) loan insurance was permitted to lapse at the end of March 1937, but was revived in February 1938 and is authorized,

along with the catastrophe loan insurance, to continue until July 1941.

Before July 1939 the cost of the insurance was borne entirely by the federal government.[19] Notes covered are those that are written primarily to finance "additions, alterations or repairs," but notes to finance the purchase of "machinery and detachable equipment," including household electric appliances, were eligible for insurance from June 1935 to April 1936. Borrowers are required to be property owners or long-term lessees. In ordinary cases notes may not exceed $2000, but higher limits have been set on special types. From the inauguration of the plan in August 1934 until its first expiration in April 1937, a total of 1,450,860 Title I modernization notes of an aggregate face value of $560,603,240 were insured; only 1 percent of the number and 10 percent of the dollar amount were for more than $2000. The average size of all notes insured was $386; for over 50 percent of the loans duration was exactly 36 months, although the range was from 6 to 60 months.

Property improved was located in nearly every county in the United States, and 6,433 different financial institutions participated in this insurance arrangement provided by government subsidy. Most of the institutions were commercial banks but 149, or 2.3 percent, were finance companies—mostly sales finance companies in the building materials field. Over the period from August 1934 to April 1937 the finance companies handled 367,357 notes with a face value of $123,653,378; these figures represent 25 and 22 percent respectively of the total number and the total amount insured by FHA during this period.

[19] Beginning in July 1939 insured institutions were required to pay a fee of ¾ percent per annum on the net advance.

2

Organization and Financial Structure

A FEW sales finance companies are organized under the partnership or individual form of business enterprise, but the great majority are corporations. In most jurisdictions incorporation is effected under the general corporation law, but in some states, as in New York, sales finance companies are incorporated under special laws covering this type of business.

Local, comparatively small companies, of which there are a large number, typically have simple corporate structures, but as the territory served increases and more kinds of business are handled, the structures tend to become more complex. Some of the largest organizations comprise a number of operating companies controlled by a holding company. Certain specialized activities, such as factorage, insurance underwriting and making small loans, are often carried on in separately organized operating companies. Complicated structures may result simply from amalgamations, or in some states they may be due in part to the fact that it is necessary under the law to have separate corporations for different lines of activity. A company's organization may appear on the surface, however, to be more complicated than the legal form actually is. Thus in many companies a small-loan or used-car department may be given an individual name and separate address, even though it operates under the same corporate charter as the parent company.

An illustration of multiple corporate interrelationship is

the Commercial Investment Trust Corporation and its subsidiaries. The operations of this organization spread over the entire United States and Canada, and include such varied types of activity as automobile financing, open accounts receivable financing, industrial and home equipment financing, textile factoring, insurance brokerage and a general surety business. The parent company, Commercial Investment Trust Corporation, has approximately thirteen wholly owned direct subsidiaries and it has a substantial majority interest in two others. These direct subsidiaries in turn own all the outstanding stock of approximately thirty-two indirect subsidiaries of the parent company, and two of the indirect subsidiaries have one subsidiary each. The corporate structure thus comprises some fifty charters, one for the parent company, fifteen for the direct subsidiaries and thirty-four for the indirect subsidiaries.

TYPES OF SALES FINANCE COMPANIES

Sales finance companies may be classified in a number of ways. One is according to the degree of specialization in financing particular types of commodities, that is, "automobile," "diversified" or "mixed." The automobile finance company purchases at retail from the automobile dealer the note and title retention instrument received from the buyer, and also lends at wholesale to enable dealers to purchase their stock in trade. The diversified finance company specializes in the financing of instalment sales of one or more articles other than automobiles, such as electric appliances, radios, furniture or industrial equipment. The so-called mixed finance company handles both automobile paper and that based on other articles.

A second classification of finance companies is according to whether a company is factory-related, that is, factory-controlled or factory-preferred, or independent. Recently

manufacturer association with sales finance companies in the automobile industry (whether such association take the form of ownership, affiliation or preference) has been under attack by the United States Department of Justice; this action will be discussed in Chapter 11. In the financing of consumer purchases of automobiles (as contrasted with purchases of trucks and cabs) the only factory-controlled company today is General Motors Acceptance Corporation, which is a wholly owned subsidiary of General Motors Corporation and confines its operations to wholesale and retail transactions of dealers handling General Motors products. Factory relationship is more frequent in the diversified field; in recent years financing subsidiaries or departments have been formed by such manufacturers as General Electric, Westinghouse, Johns Manville, Kelvinator and Berkey and Gay.

Until recently the principal factory-preferred companies in the automobile field were Universal Credit Corporation, Commercial Investment Trust Corporation and Commercial Credit Company. Universal Credit Corporation, controlling interest in which was purchased in 1933 by Commercial Investment Trust Corporation from Ford Motor Company, confined its operations to the wholesale and retail financing of Ford cars. Commercial Investment Trust Corporation had, in addition to its indirect relationship with Ford, special financing arrangements with other motor manufacturers. Commercial Credit Company was affiliated with Chrysler Motor Corporation, which owned stock in it from 1934 to 1938. Both Commercial Investment Trust Corporation and Commercial Credit Company have made a practice of serving dealers of other motor manufacturers who had no preferred relations with them, and for years both have conducted sales finance operations in appliance and other lines on a preferred or non-preferred basis. Antitrust prosecution by the United States Department of Jus-

tice of the Chrysler, Ford and General Motors companies and their affiliated finance companies resulted late in 1938 in consent decrees under which the Chrysler and Ford companies agreed to discontinue special preference for the services of affiliated finance companies. These decrees have materially affected preferred relationships between manufacturer and finance company, at least in the automobile field.[1]

The so-called independent finance company has no affiliation with, or preference from, any particular manufacturing company. It discounts instalment paper arising from the sales of various dealers in automobiles and other articles, and endeavors to build up close relations with the dealers.

A third classification of finance companies is according to the area of their operation. There are three large companies operating on a national basis—General Motors Acceptance Corporation, Commercial Investment Trust Corporation, including Universal Credit Corporation, and Commercial Credit Company. There are five large regional companies, each with offices in eight or more states: Associates Investment Company, of South Bend, Indiana; National Bond and Investment Company, of Chicago; Pacific Finance Corporation of California, Los Angeles; Bankers Commercial Corporation, of New York; and the latter's subsidiary, Maytag Acceptance Corporation, of Chicago. Local finance companies confine their operations to one community or a relatively small area, but may cover as much as several states.

The degree to which the national companies dominate

[1] The decrees are contingent, however, on the outcome of the prosecution by the Department of Justice of General Motors Corporation and General Motors Acceptance Corporation. A verdict of guilty was returned against the defendants in the fall of 1939, but notice has been filed of intention to appeal, thus leaving the issues of the case still pending. For a discussion of this action see Chapter 11.

TABLE 5

DISTRIBUTION OF ASSETS OF 48 SALES FINANCE COMPANIES, DECEMBER 31, 1937, BY TYPE OF COMPANY[a]

Type of Company	*Total Assets* (in millions)
National Companies	*$1,470.5*
General Motors Acceptance Corporation	582.2
Commercial Investment Trust Corporation[b]	544.6
Commercial Credit Company	343.7
Regional Companies	*201.2*
Associates Investment Company	79.7
National Bond and Investment Company	54.5
Pacific Finance Corporation of California	43.8
Bankers Commercial Corporation	16.3
Maytag Acceptance Corporation	6.9
40 Local Companies[c]	*166.0*
TOTAL	1,837.7

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market.
[b] Including Universal Credit Corporation but not National Surety Company.
[c] The assets of these companies ranged from $651,000 to $15,197,000.

the field is illustrated in Table 5, which shows the distribution of total assets in 1937 among forty-eight companies that use the commercial paper market. The year-end assets of the three national companies, at $1,470,500,000, were more than seven times as great as those of the five regional companies, and nearly nine times as great as those of forty of the largest local companies. The commanding position of the national companies is further indicated by the fact that in 1937 they handled 68 percent of the retail automobile credit and 79 percent of the wholesale automobile credit extended by a group of 424 sales finance companies that accounted for more than 95 percent of all automobile financing conducted by such companies.[2] Their capital and

[2] See Chapter 11, Table 67. The national companies are there designated as "factory-related."

TABLE 6

ASSETS OF SELECTED SALES FINANCE COMPANIES, 1924–39, IN PERCENT OF 1929[a]

Year-End	*National Companies*[b]	*Regional Companies*[c]	*Local Companies*[d]
1924	18.9	31.3	31.4
1925	35.3	53.9	39.0
1926	48.4	55.2	48.2
1927	51.4	56.6	45.9
1928	68.1	69.1	66.2
1929	100.0	100.0	100.0
1930	84.8	67.2	62.6
1931	69.6	67.8	67.7
1932	43.1	43.5	54.3
1933	47.3	51.7	61.9
1934	62.3	62.8	77.6
1935	84.2	99.3	108.8
1936	122.2	150.7	137.4
1937	146.3	172.6	171.0
1938	97.1	118.0	117.8
1939	110.3	116.2	115.1

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market.
[b] General Motors Acceptance Corporation, Commercial Investment Trust Corporation and Commercial Credit Company for all years, and Universal Credit Corporation from inception in 1928.
[c] Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California and Bankers Commercial Corporation for all years; Maytag Acceptance Corporation from inception in 1927.
[d] A sample of 13 for all years, selected according to availability of data.

surplus probably represented as much as half of the total of all units of the sales finance business.[3]

But the national companies' preponderance, great as it is, has been decreasing for nearly a decade. Between 1924 and 1929, as indicated in Table 6, the assets of the national

[3] In 1933 their capital and surplus ($179,500,000) represented 63 percent of the total of all sales finance companies reporting their net worth to Dun and Bradstreet. See National Recovery Administration, *Hearing on a Code of Fair Practices and Competition for the Finance Company Industry* (October 26, 1933) Exhibit H.

companies grew more than those of the regional or local companies, and in 1930 they contracted less. In 1931, however, the assets of both regionals and locals rose slightly, in percent of 1929, while those of the nationals continued to fall, and in no subsequent year did the national companies' assets reach so high a proportion of their 1929 level as did those of the other two types of companies.[4] The local companies represented in this table are a very small sample, and there is no way of knowing if they are typical of all such companies; the present data would indicate, however, that in the period since 1929 the local companies have for the most part maintained their competitive position as well as, and in some years notably better than, the larger companies.

SOURCES OF FUNDS

The rapid rise of sales finance companies after the first World War undoubtedly reveals that there was in the American economy a latent demand for consumer credit. This latent demand developed as the national income increased to a point permitting the mass ownership and operation of durable consumer goods, particularly automobiles, and it became effective with the invention of a technique by which mass credit could be granted safely and expeditiously. It is perhaps an historical accident, to be accounted for largely by legal and institutional inhibitions, that this new technique of mass credit was inaugurated and developed by new specialized financial institutions, such as sales finance com-

[4] Federal Trade Commission data for five years in the period 1927-37, covering the same national companies (designated as "factory-related" companies, and including Universal Credit Corporation for the years 1935-37) and twelve "independent" companies, show the same general trend: in 1937 the total capital employed by the factory-related companies was two and one-half times what it had been in 1927, but that of the independents was four and one-half times its earlier figure. See Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) (76th Congress, 1st Session, House Document No. 468) p. 937.

panies, rather than by the already widespread and firmly established commercial banking mechanism. These inhibitions, however, applied solely to commercial banks' direct participation in the granting of sales finance credit. Indirectly commercial banks have participated heavily from the early days of the business. In fact, the extremely rapid growth of sales finance companies in the United States could not have taken place in the absence of highly developed capital and credit markets, markets which were both able and willing to make funds available to these new institutions provided only that they were in a position to offer paper conforming in general type and character to the kinds which our markets were accustomed to absorb.

The balance sheets of the finance companies taken year by year reflect the skilled use which they have made of this existing financial mechanism. At the same time, variations among the balance sheets of the different types of companies—national, regional and local—reflect the different ways in which these various types have adapted their individual financial structures to the sources of funds that were open. An analysis of the principal sources of funds of selected sales finance companies for which data are available is presented in Table 7, for the period 1924-39. The figures are given as percentages of total assets rather than as dollar aggregates, which might be more illuminating, because data for sufficiently large groups of identical companies are not available for each of the years shown.

The first point of interest in the table is the size of the capital cushion, the proportion it has represented of total assets. For any given year alone this proportion is not necessarily typical of financial policies, since total assets are subject to wide fluctuations, but averages covering a series of years may be assumed to represent the operating policies of sales finance companies with respect to the employment of equity money as compared with borrowed funds. The

TABLE 7

PRINCIPAL SOURCES OF FUNDS OF SELECTED SALES FINANCE COMPANIES, 1924–39, IN PERCENT OF TOTAL ASSETS[a]

Year-End	National Companies[b]				Regional Companies[c]				Local Companies[d]			
	Short-Term Debt	Long-Term Debt	Equity Funds	Debt Ratio[e]	Short-Term Debt	Long-Term Debt	Equity Funds	Debt Ratio[e]	Short-Term Debt	Long-Term Debt	Equity Funds	Debt Ratio[e]
1924	68.1	..	22.9	3.0	52.8	..	36.9	1.4	52.7	..	33.0	1.6
1925	68.1	2.3	21.1	3.3	54.8	10.5	25.4	2.6	60.3	1.1	27.9	2.2
1926	61.5	11.5	18.6	3.9	45.3	18.3	26.5	2.4	59.0	.9	27.0	2.2
1927	49.0	22.0	20.5	3.5	43.6	15.0	31.9	1.8	56.6	..	32.2	1.8
1928	53.6	16.3	20.4	3.4	50.6[f]	8.7[f]	31.0[f]	1.9[f]	50.3	..	31.6	2.5
1929	50.5	13.3	25.8	2.5	42.4	9.1	38.8	1.3	57.8	1.0	31.6	1.9
1930	43.7	13.4	29.8	1.9	33.4[f]	3.7[f]	50.6[f]	.7[f]	52.1	1.2	37.2	1.4
1931	40.6	14.3	33.8	1.6	35.5	8.8	38.6	1.1	55.5	.9	30.7	1.7
1932	14.7	18.2	52.6	.7	20.3	9.7	55.9	.5	38.4	1.3	51.6	.8
1933	35.5	7.9	41.6	1.0	33.0	5.9	47.6	.8	50.9	.8	46.5	1.1
1934	46.1	4.7	33.6	1.5	41.1	3.6	40.0	1.1	51.9	.6	38.6	1.4
1935	51.1	5.0	27.8	2.0	55.0	1.9	30.6	1.9	61.3	.5	29.2	2.1
1936	45.3	17.7	20.4	3.1	51.7	8.0	28.5	2.1	60.5	2.6	27.9	2.3
1937	52.5	17.9	18.3	3.8	56.1	6.8	26.5	2.4	62.6	1.5	27.7	2.3
1938	33.8	23.9	27.8	2.1	39.3	9.8	40.3	1.2	52.4	1.7	38.6	2.0
1939	41.5	16.9	23.6	2.5	38.9	5.1	37.8	1.2	57.2	5.1	32.2	1.9

simple unweighted arithmetic averages of the annual percentages for equity funds over the whole sixteen years covered in the table are, for national companies, around 27 percent of total assets, for regional companies 37 percent, and for local companies 34 percent. These percentages are lower than would be typical of manufacturing, mining, communication and mercantile corporations, all of which require relatively heavy investment in fixed plant, equipment and inventories, but they are decidedly higher than the capital ratios that are typical of financial institutions, such as banks and mortgage companies, with which sales finance companies are more directly comparable. Since sales finance companies seldom own physical property in any large amount, such as real estate, equipment, inventories and the like, the greater proportion of these equity funds is used for financing receivables. They therefore constitute in a very direct sense a cushion for the absorption of bad-debt losses. Despite the fact that equity funds constitute a relatively large proportion of total funds employed, finance company earnings, expressed as a rate of profit on equity funds employed, have been relatively high, especially for well-managed enterprises. The high rate of profits accounts, of course, for the success of sales finance companies in attracting new capital into what was, during most of the period covered, a new and rapidly expanding business. It has also

[a] For 1924-33 based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market, and for 1934-39 based on data obtained directly from companies. The percentages do not add to 100; the difference represents corporate reserves.

[b] General Motors Acceptance Corporation, Commercial Investment Trust Corporation and Commercial Credit Company for all years, and Universal Credit Corporation from inception in 1928.

[c] Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California and Bankers Commercial Corporation for all years; Maytag Acceptance Corporation from inception in 1927.

[d] A sample of 13 for the years 1924-33, of 40 for the years 1934-38 and of 24 for 1939, selected according to availability of data.

[e] Ratio of total debt to equity funds.

[f] Based on data for 4 companies only.

facilitated the building up of equity funds out of retained earnings.

Variations in the policies of national, regional and local sales finance companies with respect to the proportion of equity funds employed are also revealed by Table 7. National companies throughout the period show a lower proportion of equity funds to total assets than do regional or local companies. In almost every year they show also a higher debt ratio, that is, a larger proportion of funds borrowed to funds owned. This undoubtedly reflects the preferred position attained by these companies in the national money markets. In fact, one of the allegations which its smaller competitors bring against General Motors Acceptance Corporation is that it can borrow five or more times its equity capital because it is owned and backed by General Motors Corporation.[5] Differences between regional and local companies with respect to the relative employment of equity funds are less distinct. It might be expected that as between these two types of companies the larger regional enterprises would show a lower proportion of equity funds to borrowed money, but this expectation is not borne out by the data assembled in Table 7. In most of the years shown, the regional companies maintained a proportion of equity funds to total assets that was slightly larger than that maintained by local companies, and also, in most years, a smaller debt ratio.

It is more difficult to draw from these data inferences concerning changes during the period in the policies that have motivated the different types of companies, the difficulty arising largely because increases in the proportion of equity funds to total assets have usually reflected a falling off in business volume rather than a policy decision to strengthen the equity position. The fact, however, that equity funds

[5] "The Automobile Finance Business," a mimeographed monograph of the American Finance Conference, Chicago (July 15, 1937) pp. 19-20.

tended to rise in proportion to total assets during the period 1926-29, when business volume was expanding rapidly, would seem to indicate that at that time all types of companies were making active efforts to strengthen their equity positions. There may also be some significance in the fact that during the peak year 1937 the proportion of equity funds to total assets was lower than in 1929 and back to the levels prevailing in 1926. This may indicate that as the business has matured, its credit standing has improved and its borrowing capacity increased.

The factor of size as an index of ability to tap the central money markets is indicated also by the extent to which the various types of sales finance companies have incurred long-term debt, and the amount, source and character of their short-term indebtedness. Table 7 clearly indicates that national sales finance companies have made fairly extensive use of long-term money markets to secure funds to finance their operations, and that the regional companies have used this source of funds to a moderate extent. Local companies, on the other hand, have been forced to rely upon the short-term money markets for practically all of their borrowed funds.

In spite of the heavy proportion of equity funds used in the sales finance business, and the supplementary drafts made on the long-term money markets by national and regional companies, short-term debt has constituted on the whole a more important source of funds for the purchase of sales finance receivables than equity funds and long-term borrowings combined. A simple average of the annual percentages presented in Table 7 indicates that for the period as a whole short-term debt represented, for national companies, around 47 percent of total assets, for regional companies 43 percent, and for local companies 55 percent. During part of the period, particularly the years after 1934, this heavy reliance on short-term borrowing was affected

by the fact that interest rates in the short-term markets were favorable. Primarily, however, it reflects the needs of sales finance companies for a source of funds that can be expanded or contracted rapidly in accordance with rapidly changing conditions. As was indicated in Table 6, the volume of business conducted by sales finance companies is subject to wide fluctuations from prosperity to depression, so wide that if business were financed wholly or even largely on the basis of long-term funds it would mean incurring heavy costs for idle money in periods of contraction. Therefore the basic needs of the business necessitate major reliance on short-term debt, even when interest rates are not particularly favorable.

From the beginning, access to these sources of funds has been fairly easy. In the early days it took the form mainly of direct loans which banks were able and willing to make. Although the business was new at that time, and did not enjoy its present high credit standing, it did possess definite attributes that served to open the channels of bank credit. Its capital cushion of equity funds was large, large enough to absorb heavy losses before there was any danger to the safety of funds advanced; its assets consisted of instalment receivables that lent themselves readily to hypothecation; when hypothecated, the paper bore the name of, and was secured by the net worth of, not only the borrowing company but also a retail dealer and a consumer buyer of the commodity financed; the paper itself was comparable to self-liquidating commercial paper in that it was repaid currently out of income and the current position of the company financed could be followed readily from its record of monthly receipts on outstanding instalment contracts; finally, the business was highly profitable, and therefore able to pay remunerative rates for ample accommodation.

As the business matured, finance companies came to be regarded as excellent risks. During recent years, when bank

failures were numerous, there were few failures among sales finance companies. For the period 1925-33 the National Association of Sales Finance Companies has records of only 39 failures. In 19 of these there was no loss to creditors. As this quality of financial stability became recognized, new sources of short-term funds were opened to the larger well-managed companies, with the result that sales finance companies now make extended use of the open market through the commercial paper houses and maintain extensive borrowing relations with hundreds of banks throughout the country.

The varied nature of this short-term borrowing under present conditions is indicated in Table 8, which presents for 1937—the latest year of large operations—a more detailed analysis of sales finance companies' sources of funds. The table shows that in that year borrowing through the open market was equivalent to 18 percent of the total assets of national companies as compared with 10 percent and 15 percent respectively for regional and local companies. Direct bank debt, on the other hand, amounted to 31 percent of total assets for the national companies, as compared with 46 and 44 percent respectively for the regionals and locals. These variations reflect, of course, the greater accessibility of the larger corporations to the open markets. By 1937 all of the bank debt of the national companies, and practically all that of regional companies, was incurred on an unsecured basis. Among the local companies, however, 80 percent of the bank debt was still secured by pledge of collateral.

In the early 1920's these collateral trust notes were quite generally used as the basis of bank borrowing, and for 72 larger companies constituted about two-thirds of total notes payable.[6] Since then first the national companies, subse-

[6] According to National Credit Office, Inc., Bank Service Department, "A Study of Specialized Finance Companies" (1927).

TABLE 8

PRINCIPAL SOURCES OF FUNDS OF SELECTED SALES FINANCE COMPANIES, 1937, IN PERCENT OF TOTAL ASSETS[a]

Capital Item	*National Companies*[b]	*Regional Companies*[c]	*Local Companies*[d]
Borrowed funds	*68.9*	*63.6*	*64.8*
Bank debt			
Secured	..	1.4	34.9
Unsecured	31.1	44.2	9.3
Open-market debt	17.9	9.9	15.0
Other short-term debt	2.4	1.2	4.2
Long-term debt	17.5	6.9	1.4
Equity funds	*17.9*	*26.8*	*28.0*
TOTAL[e]	86.8	90.4	92.8
Receivables	88.9	85.9	84.4
Total assets	$1,470,500,000	$201,200,000	$166,043,000

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market, and on data obtained directly from companies.

[b] General Motors Acceptance Corporation, Commercial Investment Trust Corporation (including Universal Credit Corporation) and Commercial Credit Company.

[c] Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California, Bankers Commercial Corporation and Maytag Acceptance Corporation.

[d] A sample of 40, selected according to availability of data.

[e] The differences between these percentages and 100 represent corporate reserves.

quently the regionals and more recently the larger locals have increasingly employed the unsecured note,[7] until in recent years collateral trust borrowing has become a relatively unimportant method of financing. In the case of local companies, where it still exists, the assembly of receivables for collateral security is a relatively simple matter. Some banks, deploring the trend, have undertaken to restrict un-

[7] Practice, however, is sometimes deceptive. One large local, for example, although it borrows on straight notes, has all notes, contracts and accounts receivable held by a trustee for the benefit of holders of the companies' notes.

secured lending to companies with at least $5,000,000 capital,[8] but this standard is not generally adhered to.

Direct borrowings are from depository banks, which in the case of national companies may number from 250 to 400. Credit lines are usually arranged in advance of borrowing in accordance with maximum expected needs, and are subject to revision, seasonally and cyclically, as business expectations change. In order to take care of any possible expansion, total credit lines arranged usually exceed actual borrowings by a wide margin.

The terms under which sales finance companies borrow from banks have probably undergone considerable change, but no data are available on their trend over any extended period. Reports from about 150 large banks in various parts of the country indicate that at the end of 1938 maturity requirements ranged from a demand basis to 24 months or longer, but the maturity most frequently reported was 6 months. Interest rates varied from 1 to 12 percent, with 1½ percent the rate most frequently required. National sales finance companies borrow on the most favorable interest terms, the spread between the rates they pay and those paid by other companies varying from under 1 percent at some banks to more than 3 percent at others.[9]

Since the early 1920's sales finance companies have availed themselves of the open market as a means of financing their needs for short-term funds. Only 6 companies used the open market in 1922, and by 1926 the number had risen to 76,[10] but at the middle of 1938 it was reduced to 63, a few of these being subsidiaries of the others and a few doing no

[8] For example, some of the large Chicago banks. See A. W. Newton, "Finance Companies," address before the Association of Reserve City Bankers at White Sulphur Springs, April 27, 1937.

[9] For fuller detail on the terms of bank borrowing by sales finance companies see National Bureau of Economic Research (Financial Research Program), *Commercial Banks and Consumer Instalment Credit*, by John M. Chapman and Associates (1940) Chapter 8.

[10] National Credit Office, Inc., *op. cit.*

retail instalment business. For companies using the open market this type of borrowing is conducted on terms as favorable as, and usually more favorable than, those regulating direct bank borrowing. It is handled by the usual commercial paper dealers, by several investment dealers or, directly, by the finance company's own organization. Maturities range up to 6 months, but interest rates, except for the largest companies, appear to run somewhat higher than rates prevailing on commercial paper regarded by the market as "prime."[11]

The proportion of total funds that sales finance companies should obtain through borrowing is a matter on which no two finance men or bankers agree. In the middle 1920's it was said that companies with the highest credit rating could then borrow five dollars for every equity dollar in their business, but that less highly regarded companies were more limited,[12] a conventional maximum standard of four dollars of debt to one equity dollar being generally accepted.[13] In 1935 the National Credit Office, Inc., reported a maximum debt standard of three times net worth to be in vogue. At the end of 1938 reports from leading banks engaged in lending to sales finance companies indicated that a standard of two and a half to three times equity funds was typical, a few banks approving a more liberal standard (4 to 1) and others a more conservative one (2 to 1 or lower).[14] Factory ownership is said to affect the attitude of bank lenders, since in such cases reliance is placed upon the financial strength of the parent company.

Because their assets consist predominantly of financial paper, the liquidity and ultimate solvency of sales finance

[11] John M. Chapman and Associates, *op. cit.*

[12] E. R. A. Seligman, *The Economics of Instalment Selling* (1927) vol. 1, p. 85.

[13] M. V. Ayres, *Installment Selling and its Financing,* report to American Bankers Association at Pinehurst, North Carolina, May 4, 1926. A. W. Grimes (*Financing Automobile Sales,* 1926, p. 66) sets the figure at one and one-half times for companies with a capital of $500,000 or less, and three to five times for those of larger size.

[14] John M. Chapman and Associates, *op. cit.*

TABLE 9

CASH AND RECEIVABLES OF 24 LEADING SALES FINANCE COMPANIES, 1935–39, IN PERCENT OF DEBT[a]

Date	Cash and Receivables[b]	
	Maturing in 6 Months or Less	Maturing in 12 Months or Less
December 31, 1935	108.8	143.8
June 30, 1936	96.3	130.3
December 31, 1936	103.5	140.2
June 30, 1937	95.9	134.8
December 31, 1937	103.1	141.3
June 30, 1938	119.9	157.5
December 31, 1938	130.4	169.9
June 30, 1939	110.3	148.0

[a] Based on special surveys by the First National Bank of Chicago, covering 2 national companies, 3 regionals and 19 locals; of these, 14 companies reported for all dates, 10 only for some dates.
[b] Wholesale, retail and other.

companies can be judged only in terms of the quality of that paper, and of the policies followed in its acquisition. A rule of thumb standard commonly applied by bankers as a test of a sales finance company's general liquidity is its theoretical ability to liquidate all debts within the span of 6 months, merely by letting its existing instalment receivables mature.[15] Table 9, which shows, for 6-month intervals in the period 1935-39, the total cash and receivables

[15] A. W. Newton, *Installment Finance Paper,* address to Federal Reserve Member Bank Conference, Minneapolis, March 12, 1938, p. 28. A well-known finance company executive, D. Cates, expresses the same thought slightly differently by stating that bank credit should not exceed cash and instalment receivables maturing within 9 months, minus operating expense and a margin shown by past experience to be enough to cover the lag in collections. M. V. Ayres, "Long Term Requirements," in National Association of Sales Finance Companies, *Time-Sales Financing* (November 1936) p. 14, observes that a finance company with a stabilized business in 12-month paper could borrow, under the criterion of 6-month liquidation, 2.71 times its own capital.

of twenty-four larger sales finance companies, in percent of debt, indicates adherence to such a standard, and also shows a substantial excess margin available for liquidating debt on a 12-month maturity limit. It should be observed, however, that there is not complete agreement among bankers as to the wisdom of adhering to a 6-month liquidity standard. Reports from leading banks in various sections of the country as of the end of 1938 indicated a preponderance of bank opinion in favor of a 5- to 7-month liquidity standard, but a large proportion of the reporting banks (more than one-third) favored a more liberal standard, the extreme being 14 to 16 months.[16]

Commercial banks that are important creditors of sales finance companies necessarily take an active interest in the quality of the retail receivables that such companies hold.[17] The banker, of course, has no way of appraising the reliability of the company's hundreds or thousands of customers, but he can ascertain the typical down payment on the merchandise financed, and the average duration of customer notes, and on the basis of past experience estimate the relative risk of the company's account. In general, banks that lend regularly to automobile sales finance companies consider as standard a down payment of one-third of cash selling price on both new and used cars, and a contract duration of 18 months on new cars and 12 months on used cars, but these standards are by no means universally held. Leading creditor banks obtain regular reports on typical down payments and instalment contract lengths, and on at least two occasions, 1924 and 1937, such banks took an active part in persuading sales finance companies to check a competitive liberalization of sales financing terms.

[16] John M. Chapman and Associates, *op. cit.*

[17] For a fuller discussion of the interest of the commercial bank creditor in the quality of instalment receivables held by sales finance companies, see John M. Chapman and Associates, *op. cit.*

3

The Market for Sales Finance Credit

THROUGH the facilities afforded by sales finance companies an army of new credit users came into the credit system within a short span of time; many others who had already made use of credit were encouraged to go into debt more extensively than formerly. Why was there this sharp increase in the practice of purchasing on the deferred payment plan? Who are these users of instalment credit? What are their economic circumstances? What kinds of goods do they buy on the instalment plan and how much do they pay for them? How much of their future income is tied up by instalment debt? These are a few of the numerous questions that might be asked about the millions of people who buy many millions of articles annually on the instalment plan and create the demand for the services of sales finance companies; some of the questions can be answered and some cannot.

INCREASE IN THE DEMAND FOR SALES FINANCE SERVICES

The majority of the sales finance companies now in existence were organized in the period from 1915 to 1929. Many factors combined to produce the expansion of instalment selling which took place in that period.

In earlier days, when the country was predominantly rural and agricultural, the retailer was frequently obliged to carry his customers until after harvest. Consumer goods

were bought extensively on what is known as book credit or open credit, the debt being paid off in whole or irregularly in parts at the convenience of the debtor, without carrying charge. But with the change from rural to urban, from agricultural to commercial and industrial life, with an increasing number of workers receiving their incomes regularly on a weekly or monthly basis, such a personal system of credit extension—which, in fact, did not have a great deal of system in it—had to be replaced by impersonal arrangements, providing for orderly methods of payment.

But the instalment system, as regularized in the sales finance company, did not merely replace, or supplement, other forms of credit. It also filled a need that had not hitherto been cared for, except meagerly and often at exorbitant rates. The people who found it difficult or impossible to save in anticipation of expenditure, but could discipline themselves to a regimen of periodic payments, were not willing, in large numbers, to pay the high charges that characterized instalment financing in its earliest days. Thus when credit facilities began to be widely available at more satisfactory rates there was an already existent demand for them which contributed to their still further development. A progressive liberalization of contract terms, stretching out payments over a longer period, characterized the rise of the business and enabled increasing numbers of lower-income buyers to provide for monthly instalment payments among their expenditures.

An important factor in this extension of sales finance company services was the invention and manufacture of certain new commodities, such as the automobile, electric washing machine, vacuum cleaner, radio, mechanical refrigerator and gas and electric range, which had a strong appeal to consumers. The possibility of owning these relatively expensive articles, and using them while they were being paid for, attracted many buyers who might never have acquired

such commodities if they had had to save the full cash price before buying. Moreover, it was not until instalment buying was introduced into the automobile industry that consumer debt became respectable. Instalment purchasing of automobiles was at first more common among higher than among lower income groups, and this, in conjunction with the prestige value of the articles bought, did much to free instalment purchasing from the social stigma which had formerly attached to it.

It should not be overlooked that the introduction of such new commodities onto the market was accompanied by an aggressive selling campaign, specifically pointing out the ease of obtaining relatively expensive commodities by use of the deferred payment plan. It was recognized by manufacturers and dealers as well as by sales finance companies that a widespread acceptance of the plan would prove a great stimulus to sales, and since the commodities were standardized, of fairly high unit price, relatively durable and resalable at second hand, the credit risk was minimized. At the present time whole industries rest upon the instalment system, and have reached their present volume largely because of it.

But these various influences could not have operated so strongly as they did, had it not been for the concurrent rise in the money and real incomes of the wage-earning and salaried classes of the country.[1] This increasing income meant that people could buy and pay and consume more than formerly on any terms of sale. Larger incomes, both actual and prospective, and the optimism they engender, make consumers more willing to borrow and lenders more willing to lend. Thus, in short, not only were new credit facilities provided by the development of finance companies, but also increasing real income gave consumers sufficient pur-

[1] See National Bureau of Economic Research, *Economic Tendencies in the United States,* by Frederick C. Mills (1922) pp. 477-79.

chasing power to meet instalment obligations, including finance charges, as they came due.

Throughout its development both the advocates and the critics of the system have generally agreed that a widespread expansion in instalment selling brings about a diversion of purchasing power; it is held that when individuals pledge their future income for goods suitable to the instalment plan they are obliged to buy less clothing and food or fewer articles of a luxury or semi-luxury nature than they would otherwise buy, and that the payment of a finance charge for the privilege of deferring payment means that fewer dollars are left for other expenditures. There has been disagreement, however, on the desirability of this change. The defenders of instalment selling have contended that if individuals were not making payments on furniture, vacuum cleaners, electric refrigerators, washing machines—all highly useful and relatively durable commodities—they would probably be spending their odd dollars for theater entertainment or luxuries of which they could have only temporary enjoyment. Others have been less sanguine about the implications of widespread instalment buying, in the belief that the resulting diversion of purchasing power warps the structure of production and adversely affects standards of consumption by encouraging extravagant, or at least unwise, expenditure.

FAMILY INCOMES AND OCCUPATIONS OF INSTALMENT DEBTORS

On the basis of data from the Study of Consumer Purchases,[2] a collaborative survey of expenditures of 60,000 non-

[2] A Works Progress Administration project conducted by the United States Bureau of Labor Statistics and the Bureau of Home Economics in cooperation with the National Resources Committee and the Central Statistical Board. For a complete analysis of these data see National Bureau of Economic Research, Bulletin 76-77 (1939), *The Statistical Pattern of Instalment Debt,* by R. A. Young and Blanche Bernstein.

relief families during the year 1935-36, conducted by several agencies of the federal government, it is possible to delineate broadly the market that is served today by retail instalment credit. On the original survey schedule the information to be obtained from each family referred only to *net change* in retail instalment debt during the year, and not to the current existence of, or to the total amount of, such debt. Therefore the use of instalment credit, that is, the total number of families indebted during the year for the time-purchase of retail goods, cannot be estimated accurately from Consumer Purchases data, because they do not account for instalment credit of relatively short duration (credit contracted and paid off within the terminal points of the schedule year). But since the commodities whose purchase underlies instalment debt are most often sold on fairly long contracts it would seem unlikely that the number of families having a net change in retail instalment debt in 1935-36 greatly underestimates the number of families indebted for instalment purchases in that year. For this reason it has been considered justifiable, in the following discussion, to use occasionally the looser terminology of "debtor families" and the like, instead of more accurate but more cumbersome phrases such as "families having a net change in debt."

According to estimates that we have derived from this survey, presented in Table 10, approximately 5,877,000 families had a net change in retail instalment debt during the year 1935-36. This number represents nearly one-fourth of all the families in the United States that were not on relief at that time. In the aggregate their increases in instalment indebtedness exceeded their decreases by nearly $408,000,000.

There was striking variation in the frequency of debt within the various family income groups. Instalment debt was least prevalent in the lowest income group tabulated—non-relief families with annual incomes under $500—but

TABLE 10

PERCENT OF NON-RELIEF FAMILIES HAVING A NET CHANGE IN INSTALMENT DEBT, AND PERCENTAGE DISTRIBUTION OF THESE FAMILIES, OF ALL NON-RELIEF FAMILIES, AND OF THE NET INCREASE IN INSTALMENT DEBT, 1935–36, BY ANNUAL FAMILY INCOME[a]

Annual Family Income[b]	*Families Having a Net Change, per 100 Non-Relief Families*	*Percentage Distribution*		
		Net Increase in Debt	Families Having a Net Change	All Non-Relief Families
Under $500	12	3.7	5.3	10.6
500–1000	19	14.8	20.2	24.7
1000–1500	26	24.2	26.5	24.0
1500–2000	30	23.5	21.0	16.4
2000–2500	30	15.5	12.2	9.5
2500–3000	29	8.0	6.5	5.2
3000–4000	24	5.5	4.8	4.8
4000–5000	22	1.7	1.5	1.6
5000 & over	15	3.1	2.0	3 2
TOTAL	24	100.0 ($407,600,000)	100.0 (5,877,000)	100.0 (24,913,000)

[a] Based on data from the Study of Consumer Purchases, conducted by agencies of the federal government. Data on "All Non-Relief Families" from National Resources Committee, *Consumer Incomes in the United States* (1938) Table 8, p. 25.

[b] Each level is inclusive of the lower figure and exclusive of the higher.

even in this group 12 percent of the families reported a net change in instalment debt during the period studied. From this level for the lowest income groups the proportion rose steadily as income increased, until it reached the level of 30 percent, or nearly one family out of three, among income groups receiving from $1500 to $2500 a year. Families with incomes above $2500 made progressively less use of instalment credit facilities. That the actual use of this type of

credit is nevertheless fairly widespread even among the highest income groups is demonstrated by the fact that 15 percent of the families with incomes of $5000 or more showed a net change in their instalment indebtedness in 1935-36.

Despite the disposition of a great number of families among the higher income groups to make use of instalment financing, the great bulk of the instalment business is concentrated among families with annual incomes of less than $3000. This concentration merely reflects the well-known fact that families with annual incomes of $3000 or more constitute a relatively small proportion of all families of the country. Table 10 indicates that in 1935-36 families with incomes of less than $3000 constituted about 90 percent of the total number of non-relief families and accounted for about 90 percent both of the number of families having a net change in instalment debt during that time and of the total net increase in that debt. It also indicates that families with annual incomes between $1000 and $3000 accounted for 66 percent of the instalment debt families and for 71 percent of the net increase in debt, despite the fact that they constituted only 55 percent of the total number of non-relief families. The fact that 90 percent of instalment debtor families received annual incomes of less than $3000 accounts in large part for the development of sales finance companies as specialized institutions apart from the commercial banks. In the field covered by retail instalment financing the amounts advanced on individual notes are relatively small, and the periodic monthly repayments much smaller still. To grant credit safely and efficiently under these conditions required the development of specialized techniques adapted to the mass handling of thousands of small risks.

Because the facilities for instalment credit have been evolved to meet the needs of families having a regular flow of income, the use of this kind of credit is much more characteristic of urban than of rural residents. In the North

Central region, for example, approximately 70 percent of the families that had a net change in instalment debt during 1935-36 were urban dwellers. Almost all income classes showed the greatest frequency of instalment debt (percentage of non-relief families having a net change in debt) in large cities, while small cities, middle-size cities and villages ranked next in the order mentioned; farm families exhibited the lowest relative use of instalment credit. Only the metropolitan centers constituted an exception to this correlation between the degree of urbanization and the frequency of the use of instalment credit: in spite of the fact that metropolises represent the highest degree of urbanization they ranked between villages and farms in the relative frequency of instalment indebtedness.[3] This is probably due partly to the well-known fact that traffic congestion in the large metropolitan centers has reached the point where it has affected the ratio of automobile ownership to population.

The data indicate also the regional differences in family instalment debt, and the main types of commodities acquired through its use. One-third of all non-relief families in the Pacific region were indebted for instalment purchases, in the North Central region one-fifth, and in the other regions one-fourth. For almost a third of the debtor families the changes in instalment debt resulted from purchases of furniture, for two-fifths they resulted from purchases of electric refrigerators, radios and "other electric equipment," for one-fifth from automobiles, and for one-tenth from miscellaneous commodities, according to estimates based on data from larger centers—metropolises, large cities and middle-size cities. The distribution of debt volume, however, as opposed to the number of debtor families, was quite different, for automobiles were by far the greatest single source

[3] Metropolises are defined as centers with 1,500,000 population and over; large cities, 100,000 to 1,500,000; middle-size cities, 25,000 to 100,000; small cities, 2,500 to 25,000; villages, less than 2,500.

of instalment debt change, expressed in dollars, being responsible for almost three-fifths of the net increase in such debt; electric refrigerators, radios and other electric equipment originated just under a third, and furniture and miscellaneous purchases the balance. For furniture, refrigerators and radios debt frequency was highest in the South; the highest debt frequency for automobiles and miscellaneous goods occurred in the Mountain-and-Plain region and for "other electric equipment" in the Pacific region.

In the $1000-3000 annual income levels the percentages of non-relief families having a net change in debt were greater for electric equipment than for any other type of commodity; they were exceeded, below the $1000 level, by those for furniture and, above the $3000 level, by those for automobiles. This frequency is corroborated by the data in Table 11 regarding the income distribution of the debtor families. It is clear from this table that the families indebted for automobiles were concentrated mainly in the $1000-4000 income levels, whereas those indebted for other commodities were concentrated mainly in the $500-2500 levels (although refrigerator debtors were relatively infrequent in the income classes below $1000, and 10 percent of the debtors for "other appliances" had incomes of $2500-3000). The net increases in debt for the various commodities were distributed in much the same way, except that 10 percent of the net increase in automobile debt was incurred by families with incomes over $5000, and the net increase in furniture debt was mainly in the $500-2000 levels.

The greater frequency of instalment buying among urban than among farm families is reflected, of course, in the occupational composition of instalment debtors. Thus only 12 percent of the non-relief families having a net change in instalment debt during 1935-36 were farm families, though farming was the principal source of income for 25 percent of all non-relief families. A larger proportion of instalment

TABLE 11

PERCENTAGE DISTRIBUTION OF NON-RELIEF FAMILIES HAVING A NET CHANGE IN INSTALMENT DEBT FOR SIX TYPES OF COMMODITIES AND OF THE NET INCREASE IN SUCH DEBT, 1935–36, BY ANNUAL FAMILY INCOME[a]

Annual Family Income[b]	*Families Having a Net Change in Instalment Debt*						*Net Increase in Instalment Debt*[c]					
	Automobiles	Furniture	Electric Refrigerators	Radios	Other Appliances	Miscellaneous	Automobiles	Furniture	Electric Refrigerators	Radios	Other Appliances	Miscellaneous
Under $500	.2	5.9	.5	4.3	2.2	3.9	.1	7.1	.5	5.1	.1	2.0
500–1000	6.1	22.4	8.7	25.7	13.1	20.7	2.5	16.4	11.1	22.4	15.1	14.5
1000–1500	16.8	26.8	24.9	30.0	28.4	28.3	13.4	39.5	29.2	33.2	26.2	20.9
1500–2000	22.7	20.4	30.5	22.0	23.4	19.7	26.9	38.0	30.5	17.5	24.7	18.9
2000–2500	20.3	11.4	17.9	10.1	13.8	12.1	20.7	6.5	18.1	9.6	17.5	18.5
2500–3000	13.5	6.7	8.6	3.6	10.1	5.6	12.7	1.2	5.5	6.0	8.0	8.8
3000–4000	11.0	4.3	6.4	3.1	5.7	5.5	9.9	1.2	4.6	5.4	7.1	11.2
4000–5000	3.5	1.2	1.8	.7	1.7	2.1	3.6	[d]	[e]	.2	1.0	4.7
5000 & over	5.9	.9	.7	.5	1.6	2.1	10.2	[d]	.8	.6	.3	.5
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0[d]	100.0[e]	100.0	100.0	100.0

[a] Based on data fom the Study of Consumer Purchases, conducted by agencies of the federal government. These figures pertain only to metropolises, large cities and middle-size cities.

[b] Each level is inclusive of the lower figure and exclusive of the higher.

[c] Gross increase minus gross decrease.

[d] This total is actually 109.9 percent because in the $4000-5000 income level there was a net decrease of 3.8 percent and in the income level of $5000 and over there was a net decrease of 6.1 percent.

[e] This total is actually 100.3 percent because in the $4000-5000 income level there was a net decrease of 0.3 percent.

debt families than of all non-relief families belonged in the wage-earning group—47 and 38 percent respectively; and the same was true for all other occupational groups combined—41 and 37 percent respectively. But if farm families are disregarded these proportions become almost identical: the wage-earning group is found to contain 53 percent of the debtor families and 51 percent of all non-relief families living in urban communities.

As is evident from Table 12, of all wage-earning non-relief

TABLE 12

OCCUPATIONAL GROUPING OF NON-RELIEF FAMILIES HAVING A NET CHANGE IN INSTALMENT DEBT, 1935–36, BY ANNUAL FAMILY INCOME[a]

Annual Family Income[b]	*Occupational Grouping of Debtor Families Per 100 Non-Relief Families*		
	Farming	Wage-Earning	Other Groups[c]
Under $500	8	15	14
500–1000	10	26	19
1000–1500	12	32	28
1500–2000	14	37	31
2000–2500	17	34	31
2500–3000	18	33	30
3000–4000	13	32	24
4000–5000	15	[d]	22
5000 & over	17	[d]	16
TOTAL	12	30	26

[a] Based on data from the Study of Consumer Purchases, conducted by agencies of the federal government. A family's occupational grouping is determined by the occupation of the person who is the chief source of family earnings. If that person is a wage-earner the family is classified in that group, even though other members of the family may have a different occupational status.

[b] Each level is inclusive of the lower figure and exclusive of the higher.

[c] Includes professional and business occupations, whether salaried or independent, and clerical occupations.

[d] Data not available.

families 30 percent had a net change in instalment debt during 1935-36, and of those in other non-farm occupations, 26 percent. In contrast, only 12 percent of the non-relief farm families had a net change in instalment debt. Among wage-earners debt frequency was above average in all income levels between $1000 and $4000, but among other non-farm occupations it was above average only in the $1000-3000 levels.

ECONOMIC CIRCUMSTANCES OF SALES FINANCE COMPANY CUSTOMERS

While the foregoing data depict fairly well the market for retail instalment credit, they do not delineate exactly the market for the services of sales finance companies. For one thing, not all commodity fields pervaded by instalment selling are extensively served by sales finance companies; in the time selling of furniture, for example, dealers most frequently carry their retail instalment paper themselves. Also, sales finance companies deal in the first instance with retailers, and it is the latter who are the initial grantors of credit to consumers. In general finance companies handle paper of buyers of all income ranges, but they may reject individual transactions for some disqualifying feature, such as the low income status of the buyer, particularly when the worth of the dealer's endorsement is in question.

Specific data on the economic circumstances of sales finance company customers are available from only two sources, one a large sales finance company which has periodically made factual studies of its retail automobile customers, and the other the Electric Home and Farm Authority, which has made a special tabulation of a sample of its appliance customers. Neither of these sets of data is employable without qualification. In the first place, they represent the incomes of individual buyers and not family incomes, even

though the income of other members of a family, as well as of the purchaser, may be available for meeting the contracted instalment payments. And in the second place, the data, based on income reports made by customers at the time of credit application, have not been verified by the companies, since both companies, in purchasing retail instalment paper, provide for dealer repurchase in the event of repossession. The private finance company has stated that it is not confident of the reliability of the reports, and EHFA has similarly evaluated its data, declaring it has found from experience that customer income reports on credit applications are more likely to be overstatements of actual income than understatements. But such data as these, in spite of their limited reliability, are both a complement and a supplement to those already presented.

Incomes of Automobile Customers

The automobile customers of the private sales finance company are located in all regions of the country and live in communities of all types and sizes. Table 13 compares their percentage distribution by income levels, 1934, with that of urban non-relief families having a net change in debt for the purchase of automobiles, 1935-36, and also with that of all urban non-relief families. The distribution of the sales finance company's customers shows a much heavier concentration in the $500-1500 income levels and a lighter concentration in the $2000-4000 income levels than does the distribution of instalment debtor families. This difference is partly ascribable to the fact that the data pertain to different years, but more largely to the fact that the income data of the sales finance company customers cover individual rather than family incomes and include single individuals, who are of course excluded from the family data. As to the latter point, it is to be noted that the distribution of the finance company's married customers is slightly

TABLE 13

PERCENTAGE DISTRIBUTION OF A LARGE SALES FINANCE COMPANY'S AUTOMOBILE INSTALMENT CUSTOMERS, 1934, OF URBAN NON-RELIEF FAMILIES HAVING A NET CHANGE IN AUTOMOBILE INSTALMENT DEBT, 1935–36, AND OF ALL URBAN NON-RELIEF FAMILIES, 1935–36, BY ANNUAL INCOME

Annual Income[a]	*Sales Finance Company Customers*[b]				*Urban Non-Relief Debtor Families*[c]	*All Urban Non-Relief Families*[d]
	All Customers	Married Customers	New-Car Customers	Used-Car Customers		
Under $500[e]	1.6	1.2	.3	2.4	.2	5.3
500–1000[e]	13.6	11.1	5.0	18.9	6.1	20.2
1000–1500	22.6	20.8	14.5	27.6	16.8	26.5
1500–2000	22.2	22.1	19.2	24.0	22.7	21.0
2000–2500	14.0	15.9	16.5	12.5	20.3	12.2
2500–3000	10.5	11.3	16.0	7.1	13.5	6.5
3000–4000	7.3	8.4	12.7	4.0	11.0	4.8
4000–5000	3.3	3.6	5.8	1.8	3.5	1.5
5000 & over	4.9	5.6	10.0	1.7	5.9	2.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

[a] Each level is inclusive of the lower figure and exclusive of the higher. Incomes reported by the sales finance company's customers are individual and not family incomes. For these customers the income levels used in the original data were not identical with those used here, and therefore these distributions should be regarded as rough estimates. The transformation from the original to the present classifications was effected by simple proration or linear interpolation.

[b] Based on a sample survey conducted by the company, covering 39,100 new-car contracts and 40,127 used-car contracts.

[c] Based on data from the Study of Consumer Purchases, conducted by agencies of the federal government, covering metropolises, large cities and middle-size cities.

[d] Data from National Resources Committee, *Consumer Incomes in the United States* (1938) Table 8, p. 25.

[e] Many customers who fall within these income groups are not entirely dependent on their own income for support.

closer to that of debtor families than is the distribution of all customers.

The important fact for present purposes is that both sets of data show the same broad outlines. For example, both the finance company married customers and the non-relief debtor families have a smaller representation in the income levels below $1500 than have non-relief families in general; in the $1500-2000 level both have about the same representation as all non-relief families; and in the levels above $2000 both have a larger representation. These figures, corroborating those presented in the preceding section, suggest that sales finance company automobile customers are drawn almost entirely from classes having annual incomes over $500 and under $4000, and are mainly concentrated within still narrower limits. The data in Table 13 indicate that nine-tenths of such customers fall within the $500-4000 income range, four-fifths within the $500-3000 range and three-fifths within the $1000-2500 range. There are, of course, differences between new-car and used-car customers in regard to income distribution. The data for this company show that while approximately four-fifths of the new-car customers were concentrated within the $1000-4000 levels, this proportion of used-car customers were contained within the lower and narrower range of $500-2500.

Other data of this same finance company indicate that there has been a conspicuous increase in the proportion of automobile instalment customers coming from lower income groups, and a corresponding decrease in the proportion of those coming from higher income groups. Table 14 shows that just over one-third of the customers had incomes under $200 a month in 1919, but that fifteen years later, in 1934, more than two-thirds fell within this income group. In large measure this shift is to be attributed to the substantial decrease in the prices of automobiles, new and used. This decrease in average price is also evident from Table 14,

TABLE 14

PERCENTAGE DISTRIBUTION OF A LARGE SALES FINANCE COMPANY'S AUTOMOBILE INSTALMENT CUSTOMERS, AND AVERAGE CASH PRICE PAID, 1919, 1925 AND 1934, BY MONTHLY INCOME[a]

Monthly Income[b]	Automobile Customers			Cash Price Paid[c]		
	1919	1925	1934	1919	1925	1934
Under $100[d]	1.2	5.7	19.3	$ 653	$ 501	$338
100–200	33.1	48.4	49.6	829	637	518
200–300	32.7	27.3	18.3	1,012	869	694
300–500	21.3	13.9	8.8	1,293	1,165	814
500 & over	11.7	4.7	4.0	1,617	1,648	975
TOTAL	100.0	100.0	100.0			

[a] Based on sample surveys conducted by the company, covering 17,955 customers from October 1, 1919, to March 1920, and 133,328 customers for the year 1925, and 79,227 customers for the year 1934.
[b] Each level is inclusive of the lower figure and exclusive of the higher.
[c] The cash price is the actual delivered price paid for the car before the addition of insurance and finance charges. Besides the F.O.B. factory price, which provides for the dealer's profit, the cash price includes charges for freight from the factory to the purchaser, for servicing and inspection by the dealer, and for extra or special accessories, equipment and paint jobs.
[d] Many customers who fall within this income group are not entirely dependent on their own income for support.

which shows that with one minor exception all income groups paid far less for their cars in 1934 than they did in 1919. Another significant factor in the shift toward lower income groups was the lengthening of the instalment contract, and the concomitant decrease in the amount of monthly payment.

Financial Obligations Incurred by Automobile Customers

The financial obligations incurred by sales finance company customers are measured by the actual dollar amounts required to meet cash selling prices, unpaid balances and

monthly payments. The financial *burden* of these commitments, however, is indicated by the ratios of these items to the purchaser's monthly income, by the percent of cash selling price required for down payment, by the length of time income is taxed by monthly payments. Tables 15 and 16 present, according to income level, available data on the financial obligations incurred in 1934 by automobile customers of the sales finance company under consideration, and on the burden that these obligations represent. Table 16 shows also the percent of purchasers having bank accounts, a point that is of interest in a consideration of financial commitments.

Table 15 reveals an unbroken tendency for average dollar amounts of cash selling prices, unpaid balances and monthly payments to increase with rising income. That is to say,

TABLE 15

FINANCIAL OBLIGATIONS INCURRED BY A LARGE SALES FINANCE COMPANY'S AUTOMOBILE INSTALMENT CUSTOMERS, 1934, BY MONTHLY INCOME[a]

Monthly Income[b]	*Average Cash Selling Price*		*Average Unpaid Balance*		*Average Monthly Payment*		*% Distribution of Customers*	
	New	Used	New	Used	New	Used	New	Used
Under $100[c]	$715	$245	$433	$160	$33	$18	7.8	30.5
100–200	759	318	458	204	35	21	45.7	53.5
200–300	824	405	490	254	39	25	25.7	11.1
300–400	887	477	528	293	44	29	9.5	2.6
400–500	929	521	552	325	47	32	4.5	1.0
500 & over	1,048	597	635	380	53	40	6.8	1.3
TOTAL	811	315	487	202	38	21	100.0	100.0

[a] Based on data supplied by the company, covering 39,100 new-car and 40,127 used-car customers.

[b] Each level is inclusive of the lower figure and exclusive of the higher.

[c] Many customers who fall within this income group are not entirely dependent on their own income for support.

TABLE 16

BURDEN OF FINANCIAL OBLIGATIONS INCURRED BY A LARGE SALES FINANCE COMPANY'S AUTOMOBILE CUSTOMERS, 1934, BY MONTHLY INCOME[a]

Monthly Income[b]	Ratio of Cash Selling Price to Income		Ratio of Unpaid Balance to Income		Ratio of Monthly Payment to Income		Ratio of Down Payment to Cash Selling Price[c]		Index of Average Length of Contract[d]		Percent of Customers with Bank Accounts[e]	
	New	Used	New	Used	New	Used	New	Used	New	Used	New	Used
Under $100[f]	9.8	3.5	6.0	2.3	.46	.25	39.4	34.7	13.2	9.2	44	25
100–200	5.2	2.3	3.2	1.5	.24	.15	39.7	35.8	13.1	9.8	58	43
200–300	3.5	1.8	2.1	1.1	.16	.11	40.4	37.4	12.8	10.0	73	63
300–400	2.6	1.4	1.6	.9	.13	.09	40.5	38.6	12.1	10.0	81	72
400–500	2.2	1.2	1.3	.8	.11	.08	40.6	37.7	11.8	10.1	83	81
500 & over	1.4	.8	.9	.5	.07	.05	39.5	36.5	12.0	9.6	89	80
TOTAL	3.4	2.2	2.1	1.4	.16	.14	39.4	36.2	12.7	9.6	66	41

[a] Based on data supplied by the company, covering 39,100 new-car and 40,127 used-car customers.
[b] Each level is inclusive of the lower figure and exclusive of the higher.
[c] Computed by deducting the average unpaid balance from the average cash price and dividing by the latter.
[d] In months. An estimate of the average contract length can best be derived by dividing the average amount of note by the average monthly payment, but since the average amount of note was not available the average original unpaid balance was used here instead. The original unpaid balance is less than the amount of note by the amount of the finance charge, and hence the length-of-contract index here given understates the actual duration. It is not unlikely, however, that the amount of understatement is relatively constant; and therefore the given series should provide a fairly good indication of the extent to which contract length varies with income.
[e] Checking account or savings account, or both.
[f] Many customers who fall within this income group are not entirely dependent on their own income for support.

automobile purchasers with higher incomes bought higher-priced cars and committed themselves for larger unpaid balances and higher monthly payments than did lower-income purchasers. But the financial burden represented by these items (Table 16) declined steadily from lower to higher income levels; that is, the ratios (to income) of sales price, unpaid balance and monthly payment fell consistently as income increased.

Thus, to take one extreme, new-car buyers with monthly incomes of less than $100 obligated themselves in 1934 to pay an average purchase price which was the equivalent of almost 10 months' income, to meet an average unpaid balance 6 times monthly income, and to make monthly payments averaging nearly half of monthly income.[4] At the other extreme, for new-car buyers having monthly incomes of $500 and over the purchase price was not quite equal to 1½ months' income, the unpaid balance was nine-tenths of one month's income, and the monthly payment was one-fourteenth of monthly income. The $100-300 income levels, which included 71 percent of the new-car buyers, showed commitments representing, approximately, 3½ to 5 months' income for purchase price, 2 to 3 months' income for unpaid balance, and 16 to 24 percent of income for monthly payments. Through all income groups the financial commitments assumed by used-car buyers were substantially less than those undertaken by new-car buyers.

A noteworthy feature of Table 16 is the tendency for average down payment (in percent of cash selling price) and average length of contract to remain almost constant

[4] The proportion of car buyers in this income group is, of course, relatively small—less than 8 percent of all new-car buyers in 1934. It is likely that when the burden is so disproportionately high, in relation to income, the purchaser is not entirely dependent on his own income for support; for example, he may be one of several wage-earners in a family, individual incomes being combined for family expenditures. In most cases instalment paper of low-income buyers carries the endorsement of one or more relatives or friends.

through all income classes. Apparently such competitive pressures as were operating in 1934 to liberalize the terms of instalment purchase were not reflected in concessions to lower-income as compared with higher-income buyers.

Table 16 indicates also the proportion of automobile instalment buyers in the various income levels who carried bank accounts. On the average, two out of three new-car instalment buyers, but only two out of five used-car instalment buyers, had bank accounts in 1934. For both buyer groups the proportion varied directly with income, and supplementary data indicate that it was larger for higher- than for lower-paid occupations.

Incomes of Appliance Customers

Information on the income of sales finance company appliance customers is not so extensive as that for automobile customers, but some data are available from the Electric Home and Farm Authority, for January-June 1938.[5] Customers acquired by this sales finance agency during the fiscal year 1937-38 came from widely diverse areas: 29 percent of them from the four Tennessee Valley states, 27 percent from California, 11 percent from Minnesota, and 33 percent from twenty-three other states mainly in the middle west.[6] Most customers resided in small and middle-size cities, rather than in large cities or rural areas. Appliances that were financed in the fiscal year 1937-38 included refrigerators (43 percent), ranges (17 percent), washers (19 percent), radios (8 percent), and others (13 percent). About one-seventh of

[5] For a full discussion of the operations and customers of EHFA see National Bureau of Economic Research (Financial Research Program), *Government Agencies of Consumer Instalment Credit,* by Joseph D. Coppock (ms. 1940) Chapters 5-6.

[6] Customers were not distributed evenly within these states but were concentrated in districts served by utilities that had financing agreements with EHFA.

the contracts were for combination purchases of two or more appliances, the average number of appliances per contract being 1.16 during 1937-38.

There is no way of knowing to what extent the customers of this government sales finance agency come from the same income groups as private company appliance customers. It is clear, however, from Table 17 that the income distribu-

TABLE 17

PERCENTAGE DISTRIBUTION OF ELECTRIC HOME AND FARM AUTHORITY CUSTOMERS, 1938, OF URBAN NON-RELIEF FAMILIES HAVING A NET CHANGE IN ELECTRIC APPLIANCE INSTALMENT DEBT, 1935–36, AND OF ALL URBAN NON-RELIEF FAMILIES, 1935–36, BY ANNUAL INCOME

Annual Income[a]	*EHFA Customers*[b]	*Non-Relief Debtor Families*[c]	*All Urban Non-Relief Families*[d]
Under $500[e]	.6	2.0	5.3
500–1000[e]	11.3	14.1	20.2
1000–1500	25.7	27.4	26.5
1500–2000	28.1	25.9	21.0
2000–2500	18.8	14.7	12.2
2500–3000	9.5	8.1	6.5
3000 & over	6.0	7.8	8.3
TOTAL	100.0	100.0	100.0

[a] Each level is inclusive of the lower figure and exclusive of the higher. Incomes reported by EHFA customers are individual and not family incomes. For these customers the income levels used in the original data were not identical with those used here, and therefore these distributions should be regarded as rough estimates. The transformation from the original to the present classifications was effected by simple proration or linear interpolation.

[b] Based on a sample of 2,000 customers for the first six months of 1938.

[c] Based on data from the Study of Consumer Purchases, conducted by agencies of the federal government, covering metropolises, large cities and middle-size cities.

[d] Data from National Resources Committee, *Consumer Incomes in the United States* (1938) Table 8, p. 25.

[e] Many customers who fall within these income groups are not entirely dependent on their own income for support.

tion of EHFA customers conforms remarkably closely with that of non-relief families having a net change in instalment debt for electric appliances during 1935-36. EHFA customers, in spite of the fact that their income data cover individual rather than family incomes, are concentrated slightly less in the income levels under $1500 and slightly more in the $1500-2500 levels; but both distributions show approximately 90 percent of the appliance debtors within the income levels of $500-3000, and about 70 percent in the $1000-2500 levels. Moreover, appliance instalment debtors, like automobile instalment debtors, are concentrated less in the lower income levels, and more in the intermediate income levels, than are non-relief families in general. For automobile instalment debtors the dividing line, where debtors and non-relief families were represented in about the same proportion, was the $1500-2000 level; for electric appliance instalment debtors the dividing line is slightly lower—$1000-1500.

The financial obligations assumed by appliance customers of sales finance companies are roughly indicated by EHFA data for 1937-38. The average cash selling price was $138 per contract, but because of the practice of "combination" purchases the average cash selling price per appliance financed was somewhat lower. Down payments averaged 16.3 percent of cash selling price per appliance financed, time payment charges 10.8 percent of instalment notes, contract lengths about 29 months, and monthly payments $5.30. The face value of contracts was on the average about the same as the cash selling price per contract, the deduction for down payment being compensated by the addition of the time payment charge. In other words, purchasers in effect paid the financing charge in the form of down payment and then paid the full cash purchase price by periodic remittances.

COMPARISON OF CASH AND INSTALMENT BUYERS

The market for retail instalment credit in general, and for the services of sales finance companies in particular, has now been roughly delineated. The question remains whether there are significant differences between cash and instalment buyers in regard to their economic circumstances. Data bearing on this question are particularly limited, and apply only to automobile buyers. It is possible that quite different conclusions would be suggested by an analysis of commodities other than automobiles. No other articles customarily bought on instalment terms entail such high upkeep expenses, and it is likely that the buyer considers these expenses when determining how he will pay for his car. Moreover, few other commodities have, on the average, such high unit prices as automobiles. Only scanty statistics have been compiled, however, on this significant aspect of instalment financing, and therefore it is necessary to make the most of such limited data as are available.

Differences between cash and instalment buyers of automobiles are shown by tabulations covering a small random sample of family expenditure schedules for the year 1935-36, assembled by federal agencies in the Study of Consumer Purchases.[7] The entire sample covers only 730 families, living in small cities situated in the Mountain-and-Plain and Pacific regions, who bought a single automobile during the schedule year. New cars were bought by 378 families, and used cars by 352; neither group contained a notably preponderant number of instalment buyers.[8] Although any conclusions based on such a small sample of cases must be

[7] We are indebted to the Bureau of Home Economics of the United States Department of Agriculture for furnishing these special tabulations for our use.

[8] Of the new-car sample 55 percent, and of the used-car sample 59 percent, bought on terms of deferred payment. About 60 percent of all new and used cars were sold on instalment terms in 1935-36, according to data assembled by the National Association of Sales Finance Companies.

carefully guarded, generally valid inferences may be drawn with the aid of accredited statistical tests for sample significance.[9]

The analysis of this sample, shown in Table 18, indicates a number of appreciable differences between cash and instalment buyers. Those who purchased new cars—which sell at higher unit prices than used cars—had, of course, considerably higher incomes than used-car buyers, but for both new and used cars cash buyers had higher incomes, on the average, than instalment buyers. For new-car buyers this difference was fairly substantial, but for used-car buyers it was not very great.

New-car buyers were slightly older, on the average, than used-car buyers, but in both groups cash buyers were somewhat older than instalment buyers. Since age and income are directly related this perhaps connotes no more than that greater earning power facilitates the purchase of new cars (which sell, on the average, for higher prices than used cars) and the payment of cash. It also suggests, however, that younger buyers may employ the instalment plan because they anticipate higher incomes in the future and because they have had a shorter earning span for building up a savings fund from which large cash purchases might be made.

For both new and used cars a higher proportion of cash than of instalment buyers were families whose principal

[9] Two methods were used to test significance. In considering occupation and other qualitative factors the chi-test was used; in considering measurable factors such as age and family income the t-test for the significance of the difference between two means was frequently used in place of the chi-test. The t-test requires more labor than the chi-test, and it is not adaptable to qualitative factors such as occupation, but for the measurable factors it is usually more sensitive.

A discussion of methods of applying the chi-test and the t-test may be found in most advanced texts on statistics. The chi-test is discussed, for example, in R. A. Fisher, *Statistical Methods for Research Workers* (6th ed. 1936) Chapter 4, and in George W. Snedecor, *Statistical Methods Applied to Experiments in Agriculture and Biology* (1937) Chapters 1 and 9. The t-test is described in Fisher, Chapter 5.

breadwinner was engaged in business pursuits. Other occupational differences between cash and instalment buyers are not so clear, and probably do not bear stressing, except

TABLE 18

SELECTED CHARACTERISTICS OF A SAMPLE OF FAMILIES BUYING FOR CASH AND ON INSTALMENT TERMS DURING 1935–36[a]

Characteristic	*New-Car Buyers*		*Used-Car Buyers*	
	Cash	Instalment	Cash	Instalment
Family income	$2842	$2385	$1775	$1627
Age of husband	44 yrs.	40 yrs.	41 yrs.	37 yrs.
Occupation	*100.0%*	*100.0%*	*100.0%*	*100.0%*
Business	38.8	28.1	31.2	17.3
Professional and clerical	47.9	47.0	27.1	38.0
Wage-earner	13.3	24.9	41.7	44.7
Family size	*100.0%*	*100.0%*	*100.0%*	*100.0%*
Husband and wife	40.6	21.6	20.8	26.0
Additional dependents	59.4	78.4	79.2	74.0
Home	*100.0%*	*100.0%*	*100.0%*	*100.0%*
Rented	41.8	56.6	54.2	66.9
Owned	58.2	43.4	45.8	33.1
Net change in family net worth[b]	*100.0%*	*100.0%*	*100.0%*	*100.0%*
Surplus	49.6	31.4	51.4	30.7
Deficit	45.4	67.6	41.6	67.3
No change	5.0	1.0	7.0	2.0
Checking account	*100.0%*	*100.0%*	*100.0%*	*100.0%*
Account reported	72.1	46.9	32.6	32.4
None or not reported	27.9	53.1	67.4	67.6

[a] Based on special tabulations from the Study of Consumer Purchases, conducted by agencies of the federal government, covering 730 families.

[b] Savings and insurance minus new debts; changes pertain to a 12-month period during the years 1935-36.

that wage-earning families who bought new cars, and professional and clerical families who bought used cars, were more predominant among instalment than among cash purchasers. Regardless of age of car or method of payment, the majority of families that bought cars included one or more children or other dependents, though the families that bought new cars for cash were more preponderantly childless than any other type of buyer. New-car instalment buyers, and used-car buyers, cash and instalment, showed a fairly close similarity in their distributions according to this characteristic.

Home ownership was reported by a greater proportion of cash buyers than of instalment buyers, and also, in each of these groups, by a greater proportion of new-car than of used-car buyers. Moreover, cash buyers less frequently incurred a deficit for the year 1935-36 in family net worth (reckoned on the basis of savings and insurance minus new debts) than did instalment buyers. Families that bought new cars for cash carried checking accounts and savings accounts to a considerably greater extent than did new-car instalment purchase families, but among used-car buyers there was no significant difference in this respect between the two types of buyers.

Taken together, these findings merely confirm the commonsense inference that the economic circumstances of families purchasing on instalment terms are generally less favorable than those of families in a position to purchase for cash. But the findings should not be thought to contradict the previous conclusion that instalment buyers exist in all strata of society. Although higher-income purchasers are found to pay cash more frequently than others, it is clear that a substantial proportion of them buy on instalment. In fact, the situation may be summarized by saying that although there are bona fide differences between cash and

instalment purchase groups, the differences are less striking than the similarities.

COMPARISON OF PRICES PAID BY CASH AND BY INSTALMENT BUYERS

A criticism frequently made of the instalment credit system is that consumers are encouraged to enter into contracts for the purchase of goods that they cannot afford, and imprudently to incur a debt that ties up future income to meet instalment payments. This criticism has two fairly distinct implications: that buyers are attracted by instalment terms who should not purchase at all, and probably would not purchase if they had to save and pay cash; and that buyers are induced by instalment terms into purchasing a good of a higher price-quality class than they would otherwise feel justified in buying. As to the first of these implications the foregoing data afford some evidence for judgment, but the answer must remain in the realm of opinion, for it is not possible to determine empirically what is prudent or imprudent for a buyer to afford. The second implication, however, raises questions of objective fact; with data available from the Study of Consumer Purchases it is possible to test statistically—though only for automobiles—whether there is a tendency for instalment purchasers to buy higher-priced commodities than purchasers from the same income group who buy the same type of commodity for cash.

It is self-evident that for a given commodity an instalment buyer pays a higher price than a cash buyer, the difference representing the finance charge. It is possible that if no finance charge were imposed for time purchasing he would still be willing to pay that higher price in order to acquire a commodity of the same type but of a higher price-quality class. In fact, there are economists of the automobile industry who contend that "making the terms easier does

not induce more people to buy cars so much as induce those who were going to buy anyway, to buy a car of higher price."[10] The customary criticism goes farther than this, however, and contends that the instalment system itself induces a consumer to spend more than he would otherwise feel justified in spending.[11]

The data pertinent to this question are derived from a sample tabulation of 5,900 family expenditure schedules obtained by the Study of Consumer Purchases from families living in small cities in East Central, Mountain-and-Plain and Pacific states, of which almost 1,400 indicated the purchase of an automobile.[12] Table 19, which contains these data, shows for both cash and instalment automobile purchases[13] the average gross price paid (including trade-in allowance and, on instalment purchases, the total insurance and finance charges) and the average net price paid (gross price minus trade-in allowance), and also the hypothetical instalment prices that would correspond to the given cash prices at each income level.

Comparison of average gross prices paid for new cars bought for cash and on instalment terms shows that in the income classes below $2500 the instalment buyers paid considerably higher prices than the cash buyers. In the $2500-4000 levels the instalment buyers paid lower gross prices, and above $4000 they paid prices only slightly higher. For instalment purchases, however, the average gross price includes insurance and finance charges. If to each given cash

[10] See the study by C. F. Roos and Victor von Szeliski, "Factors Governing Changes in Domestic Automobile Demand" in *The Dynamics of Automobile Demand*, published by General Motors Corporation (1939) p. 68.

[11] See, for example, Roger W. Babson, *The Folly of Instalment Buying* (1938) pp. 60-63.

[12] This sample tabulation too was furnished by the Bureau of Home Economics of the United States Department of Agriculture.

[13] It is significant to mention that the income distribution of instalment purchasers which is shown in this table conforms fairly closely with that shown by other samples.

TABLE 19

AVERAGE PRICES PAID FOR CASH AND FOR INSTALMENT PURCHASES OF AUTOMOBILES, 1935–36, AND PERCENTAGE DISTRIBUTION OF PURCHASERS, BY ANNUAL FAMILY INCOME[a]

Annual Income[b]	*Average Gross Price*[c]		*Average Net Price*[d]		*% Distribution of Purchasers*	
	Cash	Instalment[e]	Cash	Instalment[e]	Cash	Instalment
			NEW CARS			
$500–1500	717	780 (756)	470	541 (510)	8.7	16.5
1500–2000	778	809 (822)	509	538 (553)	15.3	29.5
2000–2500	804	861 (849)	502	553 (547)	19.6	22.2
2500–3000	880	836 (929)	578	619 (627)	19.9	15.0
3000–4000	925	872 (977)	618	632 (670)	18.5	11.0
Over 4000	940	956 (993)	666	677 (719)	18.0	5.8
TOTAL					100.0	100.0
			USED CARS			
$500–1000	143	207 (177)	101	161 (135)	18.6	17.8
1000–1500	198	321 (234)	150	241 (186)	28.0	34.7
1500–2000	283	397 (332)	199	299 (248)	25.5	26.4
2000–2500	333	431 (385)	250	341 (302)	12.6	12.7
2500–3000	347	449 (401)	269	296 (323)	8.7	3.9
Over 3000	582	500 (644)	402	394 (464)	6.6	4.5
TOTAL					100.0	100.0

[a] Based on special tabulations from the Study of Consumer Purchases, conducted by agencies of the federal government, covering 1,384 purchases. Of the new cars 367 were purchased for cash and 346 on instalment; of the used cars 334 were purchased for cash and 337 on instalment.

[b] Each level is inclusive of the lower figure and exclusive of the higher. For new cars the $500-1000 income level has been combined with the $1000-1500 level because of the small proportion of purchasers that it contains (0.5 percent of cash buyers and 4.3 percent of instalment buyers). And the specification of used-car purchasers' income levels has been stopped at $3000 rather than $4000; buyers receiving incomes of more than $4000 constituted only 2.4 percent of those buying for cash, and 1.5 percent of those buying on instalment.

[c] Including trade-in allowance and, on instalment purchases, the total insurance and finance charges.

[d] Gross price minus trade-in allowance.

[e] The figures in parentheses represent, for each income level, the average cash price plus the hypothetical total charges that would be applicable on a car of that price if bought on instalment terms (assuming, for new cars, down payments of 40 percent and contract lengths of 15 months, and, for used cars, down payments of about one-third and contract lengths of 12 months). The hypothetical charges on used cars are computed from the used-car rate charts of several leading finance companies; no allowance has been made for a possible dealer's pack.

price are added the hypothetical charges that would be required on a car of that price if bought on instalment terms it appears that in no income group did instalment buyers purchase significantly higher-priced cars than cash buyers; in fact, above the $2500 income level the instalment buyers bought notably lower-priced cars. Average net price (gross price minus trade-in allowance) was higher in every instance for instalment buyers than for cash buyers, but again when allowance is made for insurance and finance charges there appears to have been no tendency for instalment purchasers to buy cars of higher price than did cash purchasers.

In regard to used cars, however, instalment buyers in each income group up to $3000 appear to have bought cars of substantially higher gross price than did cash buyers, even when allowance is made for insurance and finance charges; instalment purchasers who received incomes amounting to more than $3000 a year bought much lower-priced cars than cash buyers. When the trade-in allowance is deducted there is much the same pattern, except that $2500 income rather than $3000 seems to mark the dividing line between instalment buyers who tended to purchase higher-priced cars than cash buyers and those who tended to purchase lower-priced cars.

It would seem, then, that only in the used-car market, where there is a wide range of prices and where price differences may mean considerable differences in quality, does the possibility of financing on instalment induce people to buy higher-priced cars than those bought by cash buyers of the same income level. This conclusion apparently does not apply to purchasers above the $3000 income level, but about 95 percent of used-car buyers received annual incomes under that amount.

It must be emphasized that the apparent extravagance which these data indicate for certain classes of buyers is not necessarily extravagance in the literal sense of the word.

If a buyer purchases on instalment a commodity of a higher price-quality class than he would be able to purchase for cash he may or may not be spending unwisely. Determination of that question depends not only on highly relative value judgments concerning what is and what is not the proper way for him to spend his money, but also on his actual and prospective economic situation, and the extent to which his fixed monthly payments make demands on his monthly income. In some circumstances his action, constituting a regulated form of saving for the purchase of a desired commodity, may be a commendable way for him to improve his standard of living. These considerations lead too far afield for discussion here, but they should be kept in mind in a consideration of this problem.

4

Credit Procedure and Credit Losses

THE market for the services of sales finance companies is tapped in the first instance by the seller of the commodity rather than by the sales finance company. The loan and credit procedure of the finance company is thus more complicated than credit procedure involving only two parties.

Since financing the instalment sales of automobiles dominates the field, the practices of companies engaged in such financing may be reviewed first; the important procedural differences between automobile and diversified financing may then be summarized.[1] The aim of the chapter is to follow credit procedure through to the completion of the transaction, and therefore credit loss experience in sales financing is also discussed, together with practice in the handling of such losses. There is of course variation in practice among individual companies in the financing of any commodity, and some variation as between commodities, but it is possible to give a general description and merely point out differences where they seem important.

LEGAL INSTRUMENTS IN AUTOMOBILE FINANCING

The relationships between the finance company, the dealer and the purchaser are given form and made specific by legal

[1] The material on credit procedure presented in this chapter has been assembled largely from interviews with finance company executives.

instruments. The most important of these are a conditional sales contract, chattel mortgage or bailment lease and, in most cases, a promissory note. When signed by the buyer these instruments evidence the sale and the credit arising from it.

The exact form of the instrument is determined principally by state laws. Conditional sales contracts and chattel mortgages are most common, except in Pennsylvania where the bailment lease is used. National companies prepare instrument forms, each designed to meet the requirements of a particular state or, where possible, a group of states.

The contract is designed to protect the finance company's claim to the collateral until payment has been made in full, and typically it contains provisions intended to guard the finance company's interest in almost every situation which might lead to loss. The promissory note sets forth the unpaid balance due (including the finance charge), and serves to make the contract easily negotiable. Some companies find that a properly designed contract serves both purposes, and dispense with the promissory note. One or both underlie and to some extent define the various relations discussed below. Dealer franchises have, at times, contained clauses relating to financing, and where formal contracts between finance companies and dealers exist, they obviously affect the relations between the parties concerned. Such contracts vary so greatly, however, and their use is so irregular that significant generalization is not possible.

RELATIONS BETWEEN DEALER AND PURCHASER IN AUTOMOBILE FINANCING

The dealer or his salesman is the first to negotiate with the potential user of instalment credit. If the purchaser needs credit in order to buy his car the debt may be handled through one of several channels. It is possible that he himself will make arrangements with a bank, loan company

or other source of funds, but ordinarily the dealer performs this service for him. In the latter case the dealer may direct the credit to one of the various financing institutions, or he may finance it with his own resources. Ordinarily the dealer is not in a position to handle the financing requirements of his customers and, except in those communities where commercial banks or industrial banking companies actively compete for this business, the predominant institution for the purpose is the sales finance company.

At the time the sale is made a contract is drawn covering the finance charge (and sometimes a "pack" for the dealer), the type of insurance, the down payment and the number of instalments; the purchaser signs the legal forms and fills out a "purchaser's statement." The dealer determines the finance charge on the basis of a "plan" or a rate chart furnished him by the finance company; in automobile financing the charge often includes insurance coverage as well as the charge for instalment financing. A standard minimum down payment and a standard maximum number of instalments are conventionally indicated by the finance company, and the dealer is strongly pressed to influence the purchaser to agree to terms within these limits. Substandard terms may be agreed upon, but in such cases the finance company may not accept the contract, or if it does it may require the dealer to endorse it with full recourse.

The customer's statement or credit application contains detailed information concerning the car and terms of sale as well as his financial status, employment, family relations and references. After the sales transaction has been arranged the dealer, before negotiating with the finance company, may verify the credit standing of the purchaser, either making the investigation himself or using the services of a credit bureau;[2] or he telephones the complete information

[2] A dealer's check before getting in touch with the sales finance company is important when he has a recourse arrangement with the company, under

on the customer's statement to the finance company's credit department, which is usually able to verify it and to make any additional checks that are considered necessary in order to give a decision on the deal within an hour or two, or at most a day. Non-recourse companies, especially when considering used-car deals, may send out an investigator to examine the collateral. This is considered necessary by many companies since the year and model number of a used car do not bear any exact relationship to its value as collateral. An investigator is often able to determine whether the car has been abused, whether it is a repainted taxi or whether for any other reason it is not a good risk. In actual practice very few deals submitted are refused by finance companies, not because they are indiscriminate in accepting paper, but because dealers have learned to refuse poor risks and to submit only acceptable ones, and because the competitive situation makes it necessary for the companies to stand ready to accept all reasonable paper of reputable dealers, even if its terms are considerably out of line with those that are customary. It is also true, of course, that paper which would otherwise be refused can be strengthened—by the requirement of a cosigner, for example—in order to make it acceptable.

The dealer now endorses note or contract, delivers it to the finance company, along with the purchaser's statement, and receives his check for the amount of the note minus the company's scheduled finance charge and the insurance charge. In the majority of cases he is now out of the picture; only in cases of serious delinquency or repossession does the dealer again become involved, and then in greater or

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which he assumes responsibility for loss. For such a check dealers rank credit bureau reports first, personal investigation second and other mercantile credit agencies third, according to reports received from 56 automobile dealers responding to a questionnaire survey conducted among its members by the National Retail Credit Association in cooperation with the National Bureau of Economic Research (Financial Research Program), July and August 1939.

less degree depending both on the type of endorsement and on the policy or "plan" of the finance company for that particular type of deal. In retail financing, further credit relations are ordinarily between company and purchaser.

RELATIONS BETWEEN FINANCE COMPANY AND PURCHASER IN AUTOMOBILE FINANCING

After the various data on the contract have been verified, and the check issued to the dealer, a "welcome letter" or notification is sent to the purchaser, along with a coupon book or record-of-payment card. The notification informs the purchaser that the finance company has bought his contract from the dealer, and instructs him how to make payments. If a coupon book is used the purchaser merely mails his payment, with a coupon, on each instalment date. Some finance companies prefer a record-of-payment card; the purchaser uses this as a record form and sends with his payments a memorandum of the account number.

Occasionally insurance is placed by the purchaser, and in a few states it may be placed by the dealer, but in automobile financing this is usually done by the finance company, providing protection against loss due to fire, theft, collision, conversion and confiscation. Collision insurance is usually of the twenty-five or fifty dollar deductible type. Sometimes, on small and therefore low-risk contracts, collision and, more often, conversion and confiscation insurance is carried by the finance company itself through its loss reserves. A great many finance companies own their own insurance companies, but some of them place their business with independent insurance companies with which they have contractual relations.

The finance company may purchase either single-interest or double-interest insurance, that is, it may cover only its own interests or it may cover both its own and the pur-

chaser's interests; the latter type is more usual. Also, insurance may be issued in two ways: a blanket policy may be made out to the finance company, which in turn issues certificates of insurance to the purchaser; or individual policies may be issued by the insurance company and delivered to the purchaser, either by the insurance company or by the finance company.

As long as the purchaser makes his payments with reasonable promptness the finance company makes no effort to establish personal contact with him. All accounts are reviewed daily, and when one becomes from 2 to 5 days delinquent it receives special attention. Most finance companies have a series of form notices of delinquency which are mailed at follow-up intervals of a few days, the period depending upon the time required to receive an answer. If these are not successful in bringing payment the account is removed from the normal collection file and assigned to a credit man for personal attention. The type of attention it receives is dependent on the history of the account, the original creditworthiness of the deal and the number of payments that have been made. Since three out of four repossessions, generally speaking, are made on contracts that become delinquent before five payments are made, delinquencies on any of the first four payments receive particularly close attention. Often personally signed form letters are sent, followed by specially dictated letters or telephone calls.

By this time 15 to 25 days have passed, and if payment is not forthcoming more positive action must be taken. A representative with rather broad authority to act makes a personal call on the delinquent purchaser. His job is to get prompt payment of the account, to adjust it so that payment will be possible or to repossess the collateral. It is usually to the advantage of the finance company to make every effort to adjust the difficulty with the purchaser without resorting to repossession, since the average repossession

TABLE 20

RETAIL AUTOMOBILE BALANCES OVER 60 DAYS DELINQUENT OWED TO 24 LEADING SALES FINANCE COMPANIES, 1935–39, IN PERCENT OF TOTAL RETAIL OUTSTANDINGS[a]

Date	*Average*	*High*	*Low*
December 31, 1935	.77%	9.49%	None
June 30, 1936	.43	1.73	.008%
December 31, 1936	.50	2.68	None
June 30, 1937	.40	1.23	.008
December 31, 1937	.56	2.01	.06
June 30, 1938	1.30	4.80	.16
December 31, 1938	.90	3.29	.05
June 30, 1939	.80	2.47	.06

[a] Based on special surveys by the First National Bank of Chicago, covering 2 national companies, 3 regionals and 19 locals; of these, 17 companies reported for all dates, 7 only for some dates. For each date delinquencies are expressed in percent of total retail receivables outstanding during the preceding six-month period.

means a loss either to the finance company or to the dealer, and perhaps to both. On the other hand, as the delinquency lengthens, the collateral is depreciating in value, even though the unpaid balance of the note remains constant; therefore quick action is deemed necessary. The problem of the finance company's representative is to settle the matter without resorting to repossession if at all possible, but to act quickly if, in his opinion, the purchaser is unwilling or unable to pay and repossession is necessary.

As a result of this procedure delinquency is kept at a relatively low level in automobile financing, much lower than is typical among certain cash loan instalment credit agencies, particularly personal loan companies.[3] Illustrative of this tendency are the figures in Table 20, showing retail

[3] See National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices*, by Ralph A. Young and Associates (1940) Table 17, p. 74.

balances over 60 days delinquent, in percent of total retail receivables outstanding. During 1935-39 the averages for all companies reporting ranged from a low of 0.4 percent to a high of 1.3 percent. The highest percentage reported by an individual company was 9.5, and there were companies reporting no accounts at all that were over 60 days delinquent. Practice in reporting delinquencies varies, however, among different companies, some companies including in "delinquencies" not only overdue instalments but also outstanding balances due on cars that have been repossessed but not yet liquidated.

It is sometimes possible to adjust the delinquency by extending the contract for 30 or 60 days, or the contract may be rewritten to allow smaller payments and more instalments. The latter method is not uncommon; in ordinary years, according to the experience of a large company financing automobile sales, approximately one out of every twenty new- and used-car retail contracts purchased is adjusted or refinanced, and in depression years one out of every five to eight. On extended or rewritten contracts some companies charge interest and some assess a flat charge or a new finance charge comparable to the original one.

Another possibility is to influence the purchaser to refinance his debt through some other institution. If he is able to do this at all it is likely to be through a small loan company. A number of finance companies, as pointed out earlier, have established small loan or industrial banking subsidiaries in recent years, which seem to have been organized in part at least to handle such cases within the legal boundaries of the small loan or industrial banking acts.[4] These

[4] The refinancing data of the company cited above indicate that renewal or refinancing as a means of adjusting delinquent contracts was relatively infrequent before 1929. This conclusion seems to be confirmed by the fact that most small loan or industrial banking affiliates of sales finance companies have been established since that year.

various methods of adjustment are most often effective when the purchaser is only temporarily embarrassed or when he has a substantial equity in his car and therefore a strong incentive to complete his payments.

If contract readjustment fails as a means of settling an overly delinquent account, repossession follows as the final solution. In the experience of a large company financing automobile sales, about three-fifths of the cases of excessive delinquency eventuate in repossession, though the proportion may be smaller in years of receding business activity and employment;[5] repossession cases occur three to seven times more frequently among used-car than among new-car transactions.

Several methods of repossession may be resorted to by the company's representative. In many cases the purchaser has lost hope of keeping possession and surrenders the car voluntarily. If he does not, the representative takes possession by self-help—which usually means "lifting" the car from the street[6]—provided he can manage this without resort to force. If the purchaser resists, the finance company must resort to action of replevin or of claim and delivery. In the ordinary case, where the finance company has a clear right to repossess, either voluntary surrender or lifting the car may be desirable for the purchaser as well as for the company. Court action results in costs estimated variously at from $2.50 to over $20;[7] these are chargeable against the account of the purchaser, and the finance company may or may not be able to collect them.

There are occasional instances of conversion of collateral

[5] This is the proportion of repossessions to repossessions plus renewals.

[6] The contracts typically contain clauses allowing the finance companies to repossess without resort to formal legal processes.

[7] M. W. Adelson, "The Mechanics of the Installment Credit Sale" in *Law and Contemporary Problems*, published by Duke University, vol. 2, no. 2 (April 1935) p. 236; also Joseph G. Myerson, "Practical Aspects of Some Legal Problems of Sales Finance Companies," *ibid.*, p. 245.

by the purchaser, and of confiscation by public authorities of financed cars used for illegal purposes. The term "conversion" has here a more limited meaning than in ordinary legal usage. It applies to those cases, known to the trade as "skips," in which the customer disappears with or fraudulently sells or otherwise disposes of the collateral. Such cases are specifically excluded from the theft policies; the latter protect only against loss from pilferage by outside parties. Confiscation is not so frequent now as it was during prohibition, when cars bought on instalments were sometimes used for illegal transportation of liquor and were subsequently seized by public authorities.

RELATIONS BETWEEN DEALER AND FINANCE COMPANY IN AUTOMOBILE FINANCING

The relations between the dealer and the finance company encompass the granting and liquidation of wholesale credit as well as the financing of retail deals. The financial reliability of the retailer is therefore of considerable importance to the finance company. It is also of some importance in the retail finance business, when repossession is necessary. Even where the business is on a non-recourse basis the dealer has made certain warranties about the validity of title and the like that may make him financially responsible in case the purchaser defaults, and there are few if any non-recourse companies that do not do some recourse business.

For these reasons an important part of the work of the finance company's credit department is to make a careful original investigation of the dealer and to keep in touch with the changes in his financial position. Not only are the usual investigations made through financial statements, credit reporting agencies and references, but once a credit line has been established, the dealer's own payment record on his

wholesale financing and the record of the accounts purchased from him are watched closely, and statistical records of varying completeness are kept of the trend of his business. Either delinquency on his own wholesale financing or a large percentage of delinquencies in deals purchased from him has a bearing on the credit line extended, and in extreme cases might be a reason for discontinuing the purchase of his notes.

Another phase of credit supervision is the discovery and investigation of signs of irregularities, such as the receipt of instalment payments direct from the dealer. This may be merely a reflection of the financial habits of purchasers in the particular community served by the dealer, but in the past it has been evidence that a financially unsound and unscrupulous dealer has defrauded the finance company by selling it paper covering "phantom" transactions. Other fraudulent practices sometimes engaged in by dealers are duplicate wholesale financing, whereby the dealer borrows money from different finance companies, pledging the same security in each case, and the discounting of retail paper to a company other than the one that has made the wholesale loan on the car, failing to pay off the wholesale loan. Such practices are rare in comparison with the total number of transactions handled, but they are common enough to be a serious source of loss, especially since the dealer who engages in them usually does so on a large scale. In the early days of sales financing a filing bureau was organized in New York, and a few years later another was organized in Chicago, for the purpose of preventing such losses. Early in 1940 the two bureaus were amalgamated, and the Galloway Service of Chicago now provides a filing service for the entire country. Finance companies subscribing to the service notify the bureau of the identification of each car financed either at wholesale or at retail, and notify it also when the transaction

has been closed. The bureau is thus able to detect instances of double financing and to notify the companies involved.[8]

The more or less informal agreements or understandings between the finance company and the dealer are of equal importance with the legal instruments in determining the nature and extent of the business relationships. Many local companies make these understandings with each dealer to meet a particular competitive situation; in such cases they vary considerably from dealer to dealer or even from one deal to another. The better established companies are likely to have more consistent policies, often printed in folders or booklets which are distributed to dealers. These are known to the trade as "plans." All companies have a wholesale plan and at least one retail plan. The retail plans can be classified generally into non-recourse and recourse, or repurchase agreement, plans. This distinction has been of importance in the competitive situation which will be discussed later, and is of interest here since it broadly determines the relationships between finance company and dealer after repossession.

If a contract has been endorsed by the dealer without recourse, and if there is no repurchase agreement, the dealer's liability almost always ceases at the time the contract is purchased by the finance company. Only in the unusual case where he is liable under the warranty in the contract or endorsement is this not true. Ordinarily the finance company makes the repossession, disposes of the repossessed collateral and assumes the loss, if there is one. The dealer may be in-

[8] In 1932, according to information received from Galloway Service, the number of duplication reports was as much as 16.8 percent of the number of registrations. Since that year the percentage has been lower, as follows: 13.3 in 1933; 11.1 in 1934; 9.7 in 1935; 12.2 in 1936; 10.9 in 1937; 10.7 in 1938; 10.2 in 1939. Some of these cases of double financing are paid off, of course, by the time the report reaches the subscriber. About 4 to 5 percent of registrations are found to be incorrect or incomplete descriptions of the collateral on which money has been advanced, but it is estimated that the figure would be as high as 10 percent if it were possible to check all inaccuracies of this type.

formed of the delinquency, and may even cooperate with the finance company in its attempts to collect, but this is done to improve relations with the finance company and as a guide to possible future relations with the purchaser.

Endorsement by the dealer with full recourse[9] is somewhat unusual today, but may be found occasionally, usually on what are regarded as substandard contracts. In such cases the dealer is responsible for full payment to the finance company of the unpaid balance on the contract. If the car has to be repossessed he is obligated to pay the finance company the remaining balance, and he then recovers what he can by sale of the car, if it is recoverable, and possibly by subsequent action against the purchaser.

The dealer's liability is today ordinarily modified to some extent by the provisions of the repurchase agreement plan. Under such plans the dealer's liability derives not from his specific endorsement of the individual contract, but from a separate agreement in which he assumes responsibility for payment of the unpaid balance in the event of default and repossession. The difference between specifying the liability of the dealer on each contract and specifying it in a general repurchase agreement covering all or some contracts, is of course merely a matter of form, but the repurchase agreements also contain certain stipulations that modify the dealer's liability. The plans of individual companies differ but they usually include such provisions as allowance for costs of repairs due to proved collisions, protection against loss from conversion or confiscation by allowing relief from liability if the car is not repossessed within an agreed time, and delay of the request to remit the unpaid balance, in order that the dealer may have time to sell repossessed cars. The

[9] There are intermediate types of endorsements between those made with and without full recourse. These may be classed as endorsements with "partial recourse," but they are a small percentage of the total. An example is the case in which the dealer, through his endorsement, guarantees payment only for the first few months.

dealer may make the repossession, but more commonly the finance company does this and may even assume the expense, if it has not been unusually heavy. If there is evidence of fraud the finance company will take action against the purchaser and attempt to obtain a deficiency judgment.

Not only is the dealer's liability thus specifically limited in most cases, but also he receives from the finance company a certain amount of material protection against repossession losses. In business taken with recourse the finance company usually sets aside a "dealer's reserve" of 1 to 3 percent of the original amount of the contract, depending on the size of the contract and on whether the car is new or used. This reserve is payable to the dealer periodically if his liability on the contracts from which it arose has been discharged.

PROCEDURE IN DIVERSIFIED FINANCING

The broad outlines of the loan and credit procedure sketched for automobile financing fit the procedure in diversified financing, but certain differences should be pointed out. These arise for a number of reasons. The products sold, ranging all the way from inexpensive electric appliances to oil burners, have in general much lower prices than automobiles. The collateral underlying the credit becomes a part of the home or furnishings of the purchaser, and is not traveling about the country as the car is. While an automobile dealer's principal business is selling automobiles, and some three-fifths of them on the instalment plan, the dealer in diversified products is likely to sell many articles that are not sold on the instalment plan, and therefore does a larger proportion of his business for cash. Electric appliances, for example, are sold not by electric appliance dealers alone, but by a large variety of retailers ranging all the way from the corner drugstore to the electric power company.

The legal instruments for diversified financing are the

same as those for automobile financing, except for certain details which are not important for the purposes of this discussion.

The relations between the dealer and the purchaser are quite similar, with a few exceptions. While dealers are urged to obtain as large a down payment and as short a contract life as possible when negotiating the sale with the customer, this appears to be a less important problem than in automobile financing. Customary terms are more liberal and the original selling price is lower than in the case of passenger cars, and therefore down payments and monthly instalments are smaller in relation to the purchaser's income.

The credit investigation is much the same for purchasers of diversified products as for automobile buyers, although in this field a heavier responsibility for the investigation falls on the dealer, because the business is typically conducted on a recourse basis. Also, since the down payment is lower, somewhat less reliance is placed on the collateral and somewhat more on the willingness and ability of the purchaser to pay. Consequently dealers make extensive use of reports from retail credit bureaus and often check the customer's past payment record with other mercantile agencies.[10] Not infrequently the dealer's investigation includes a personal

[10] In the questionnaire survey mentioned above (footnote 2) returns from 688 retail establishments (like those from automobile dealers alone) indicate that reports from credit bureaus are considered to be the most important source of information, some retailers relying entirely on this source. The types of stores surveyed, and the number of replies, were as follows: department stores, 176; furniture stores, 134; clothing stores, 116; dealers in automobiles, tires and accessories, 56; jewelry stores, 45; lumber dealers, 43; coal and fuel dealers, 37; miscellaneous (including, among others, hardware stores, home appliance dealers and music stores), 81. By grading their answers according to a point system, allowing 3 points to a source ranked first in importance, 2 to one ranked second, and 1 to one ranked third, credit bureau reports received a total of 1,936 points, personal investigation 833 points, and reports from other mercantile agencies 579 points. In addition to the types of credit information listed on the questionnaire, one or more retail stores mentioned as being important a personal interview with the applicant, information from employer, information from relatives, a banking reference.

interview and possibly a visit to the neighborhood of the buyer's residence in order to determine the kind of house in which he lives and perhaps to make inquiries at the corner store or tavern.

In signing the contract the purchaser, as a rule, agrees to assume the risk of loss from fire, storm, theft and other special causes, and in some cases to insure the collateral against such losses, though the dealer and the finance company usually take no part in the placing of the insurance. Sometimes, however, the sales finance company will itself assume the risks of such losses;[11] in fact, reports indicate that there is at present an increasing tendency for diversified finance companies to follow this practice.

In diversified financing, since the dealer usually assumes the main responsibility for the repayment of the credit, the finance company has a less clearly delineated interest in its dealings with the purchaser in the event of delinquency and repossession. As a general rule, the finance company furnishes the dealer with periodic lists of delinquencies, and is more inclined to wait for him to take the initiative in readjustments, repossession or settlement of the note than it is in automobile financing.

Efforts to rehabilitate the account are similar to those in automobile financing, but they often extend over longer periods. Frequently outside agencies are recommended to the purchaser as aids in refinancing, though the possibility of losing customer goodwill may deter a dealer from urging their use. Questionnaire reports on this subject from all kinds of retail establishments reveal that of 688 reporting stores 70 percent suggest to customers the use of outside

[11] This is the practice of certain national companies that conduct diversified financing, and also of the Electric Home and Farm Authority. The latter's repurchase agreements with its dealers stipulate that they will be relieved of their repurchase obligation on any contract "with reference to which and to the extent in which the property securing the contract is damaged from fire, lightning, flood, cyclone, windstorm, earthquake, tornado, or theft."

agencies for refinancing.[12] Roughly three-fourths of the clothing and furniture stores and automobile dealers reported this practice and, at the other end of the scale, slightly over half of the jewelry and miscellaneous stores. The personal loan departments of commercial banks were the agency most frequently recommended and, except in the practice of department stores, industrial banking companies were a very close second; automobile dealers recommended these two agencies in the same proportion, and lumber dealers gave a slight preference to industrial banking companies. By all types of stores personal finance companies were recommended less frequently than the other two agencies, and comparatively few references were made to "other agencies" of consumer instalment credit.

If rehabilitation or readjustment of the contract fails, the dealer and the finance company find it to their interest to cooperate closely in making repossessions, and in some cases the finance company will take the action itself. Repossessions are ordinarily made at the end of 60 days of delinquency. While contracts often provide for the possibility, repossession by self-help is not usual, since the collateral is likely to be in the home, where it is difficult to "lift" it without trouble. More often than in the case of automobiles the collateral is voluntarily surrendered, and it is only occasionally necessary to resort to replevin action.

Although dealer recourse is customary in diversified financing, some companies offer a limited recourse plan, whereby the dealer's liability is limited to the period of the first four— or, more usually, six—instalment payments, provided they are met promptly. Under such plans, however, there are usually so many special stipulations and exceptions that the finance

[12] These reports were received in response to the questionnaire survey mentioned above (footnotes 2 and 9). Approximately the same results were obtained from a test questionnaire conducted in April 1939 in cooperation with the National Retail Dry Goods Association and the National Retail Furniture Association.

company is able to construe the transaction as full recourse, if it so desires. Such limited recourse business is typically conducted under agreements with the manufacturer, and the latter, in cases of repossession by the finance company, provides a market for the merchandise.

CREDIT LOSS EXPERIENCE

This survey of general procedures indicates, incidentally, what are the sources of loss in sales financing: delinquency accounts that eventuate in repossession; conversion of collateral by the purchaser, known in the trade as "skip"; confiscation of collateral by a public authority; damage to the collateral from accidental causes not covered by insurance; fraud on the part of the dealer; and readjustment of contracts to accommodate purchasers and dealers. The relative importance of these sources of loss varies from one retail instalment field to another (conversion, confiscation and collision, for example, are important only in automobile financing), and varies also among different dealers and finance companies, in accordance with the effectiveness of procedures and the nature of credit policies.

Relatively high credit losses are not necessarily unprofitable, nor do relatively low credit losses necessarily lead to profits. High credit losses may be compensated as an expense item by greater income from a larger volume of financing, obtained by less stringent procedures and more liberal credit policies. Low credit losses, on the other hand, may be more than offset by unusually high collection expense. Credit losses are costs of doing business, and as long as they are covered by charges for the service some credit agencies are not concerned about them. But while it is true that many credit agencies conduct a highly profitable business with relatively high credit losses, it is also true that many of them have caused only difficulties and embarrassment for them-

selves, their customers and their creditors through extending easy credit.

Probably the best general index of credit loss experience in retail instalment financing as a whole—not merely in the business of sales finance companies—is the proportion of "bad-debt" losses incurred by retail dealers in the extension of instalment credit. Such losses are those that result from net charge-offs, that is, from the unpaid instalment receivables charged off as worthless over a given period minus recoveries on repossessions and on charge-offs of previous periods. The net charge-offs of a period are ordinarily computed as a percentage of the face amount of instalment paper handled in that period, or as a percentage of the total amount of instalment sales made during the period. For published reports dealers generally prefer loss percentages computed in the latter manner, since they are necessarily lower than those computed against the volume of instalment paper handled (sales minus down payments).

Bad-debt loss percentages (in relation to instalment sales) over the period 1929-38 are presented in Table 21 for a small sample of retail dealers, covering four types of stores: automobile, department, furniture and jewelry. The percentages are shown to run lowest for automobiles, somewhat higher for the commodities financed by department stores, higher still for those financed by furniture stores, and highest for the instalment financing of jewelry stores. From year to year, whatever the general business conditions prevailing, this ranking is consistent. It cannot be inferred that this variation in credit loss experience has one simple explanation, as for example the character of the products financed. This may indeed be partly the explanation, but the variation arises also from differing credit procedures and policies and from the differing economic groups from which customers are principally drawn.

TABLE 21

CREDIT (BAD-DEBT) LOSSES ON INSTALMENT SALES OF SELECTED RETAIL DEALERS, 1929–38, IN PERCENT OF TOTAL INSTALMENT SALES[a]

Year	*Automobile Dealers*	*Department Stores*	*Furniture Stores*	*Jewelry Stores*
1929	..	1.48	3.11	7.13
1930	..	1.85	3.89	8.91
1931	..	2.68	6.19	12.88
1932	..	3.92	10.08	18.77
1933	0.46	2.97	5.32	13.44
1934	0.35	1.44	2.66	6.72
1935	0.28	1.01	1.71	4.94
1936	0.23	0.81	1.29	3.77
1937	0.23	0.81	1.38	3.51
1938	0.42	1.13	1.46	4.17

[a] Based on United States Department of Commerce, Bureau of Foreign and Domestic Commerce, *Retail Credit Survey* (1930-38). Bad-debt loss is the total of accounts determined to be uncollectable in a given period, minus recoveries during the same period on old accounts previously charged off. This amount is here taken to be an index of credit loss since the latter is composed primarily of "bad-debt" loss.

Each issue of the *Retail Credit Survey* presents the experience of an identical group of stores over a two-year period (the year of issue and the previous year). From these data the percentage changes in the bad-debt loss figures from one year to the previous year were calculated for each type of outlet; the percentage changes were then calculated against the 1938 bad-debt loss figure to derive the figure for each year. Because of the very small sample of jewelry stores reporting during the 1929-32 period, jewelry bad-debt loss figures for these years were adjusted in the light of department store experience.

In the business of a sales finance company a credit loss percentage figured on the basis of the total amount of retail instalment sales would not be relevant, though one reckoned on the face amount of retail instalment paper handled would be. The trade, however, commonly employs as an index of credit loss experience the percentage of retail losses during a given period to the retail paper liquidated during that period. Table 22 gives such figures for six-month intervals

TABLE 22

RETAIL CREDIT LOSSES OF LEADING SALES FINANCE COMPANIES, 1935–39, IN PERCENT OF RETAIL RECEIVABLES LIQUIDATED[a]

Date	*Average*	*High*	*Low*
December 31, 1935	.75%	1.49%	.21%
June 30, 1936	1.08	1.41	None
December 31, 1936	.92	2.10	.005
June 30, 1937	.64	1.31	.09
December 31, 1937	.89	1.77	.06
June 30, 1938	1.87	4.01	.16
December 31, 1938	1.70	3.37	.74
June 30, 1939	1.06	1.46	None

[a] Based on special surveys by the First National Bank of Chicago, covering 24 companies handling mainly automobile paper—2 nationals (omitted from this tabulation), 3 regionals and 19 locals; of these, 13 companies reported for all dates, 9 only for some dates. For each date losses are expressed in percent of retail paper liquidated during the preceding six-month period.

over the period 1935-39, covering twenty-two companies handling mainly automobile paper. The average retail credit losses of all companies reporting ranged from a low of 0.64 percent (June 30, 1937) to a high of 1.87 percent (June 30, 1938); the highest loss figure reported by any one company was 4.01 percent, and the lowest was no losses at all. Credit loss percentages so reckoned are necessarily higher than those figured from total retail instalment sales or from face amount of instalment paper handled.

It is important to distinguish between credit losses that are an expense to the dealer and those that are an expense to the sales finance company. Previous discussion has made it abundantly clear that the instalment sale may or may not involve a finance company, but that when it does, contractual arrangements with the dealer may provide for a sharing of credit losses.

For this reason sales finance company credit losses alone

are no measure of the amount of credit loss to which retail instalment transactions give rise; they indicate only the credit losses which for competitive or other reasons the finance company is unable to avoid or shift to dealers. It necessarily follows that credit losses of sales finance companies vary according to whether their retail volume is composed predominantly of recourse or non-recourse business. On recourse deals finance companies generally accept responsibility for losses arising from the readjustment or refinancing of contracts and, in automobile financing, those arising from collision, conversion and confiscation; their losses include also those resulting from dealer fraud. On non-recourse deals, however, finance companies assume all credit losses, including those from repossession. The business of some companies is exclusively recourse, and that of others is mixed, but no company, according to the trade, does an exclusively non-recourse business.

As to loss experience on recourse deals, data from a large sales finance company engaged in recourse financing, presented in Table 23 for the period 1929-38, may be taken as illustrative for the automobile field. This company's retail losses in automobile financing, like those of other recourse companies, comprise mainly losses from conversion, confiscation and collision, and also some arising out of contract readjustments and fraudulent deals. Under the terms of its financing arrangements responsibility for such retail losses is assumed by the company under most conditions, but in specified circumstances it is either shared with or assumed by the dealer. The table shows losses in percent of total retail paper purchased during the year in which the loss paper originated, and it indicates that the maximum loss was 0.34 percent on new cars and 1.02 percent on used cars (both in 1930); the minimum loss (disregarding 1938, for which year data on volume are incomplete) was 0.02 percent on new

TABLE 23

NET RETAIL CREDIT LOSSES OF A LARGE SALES FINANCE COMPANY ON REPURCHASE-AGREEMENT AUTOMOBILE FINANCING, 1929–38, IN PERCENT OF TOTAL RETAIL PAPER PURCHASED DURING YEAR IN WHICH LOSS PAPER ORIGINATED[a]

Year[b]	*New-Car Paper*	*Used-Car Paper*	*All Cars*
1929	.28	.71	.43
1930	.34	1.02	.62
1931	.24	.82	.47
1932	.18	.62	.37
1933	.07	.38	.19
1934	.05	.33	.15
1935	.04	.26	.12
1936	.02	.25	.10
1937	.03	.26	.13
1938	.01	.01	.07

[a] Based on data supplied by the company. Net credit losses are gross charge-offs (resulting principally from collision, confiscation and conversion) minus recoveries; since they are here related back to the year in which the loss paper originated, the loss data on 1938 volume are incomplete.
[b] Year in which loss paper originated.

cars and 0.25 percent on used cars (both in 1936). Total credit losses on retail passenger car business ranged from a high of 0.62 percent to a low of 0.10.

Data illustrative of sales finance company credit losses on non-recourse financing are not available from any company operating principally on that basis, but the magnitude of at least repossession losses in non-recourse automobile financing is suggested by tabulations published by the National Association of Sales Finance Companies. Table 24, which presents estimates on such losses for 1929-38, shows a range from a low of 0.58 to a high of 2.42, expressed in percent of the total retail paper that was purchased during the current year.

These figures are of course but approximations of re-

TABLE 24

AVERAGE LOSS PER REPOSSESSED CAR ON NON-RECOURSE AUTOMOBILE FINANCING OF REPORTING SALES FINANCE COMPANIES, 1929–38, AND ESTIMATED AVERAGE RETAIL REPOSSESSION LOSSES ON SUCH FINANCING IN PERCENT OF TOTAL RETAIL PAPER PURCHASED DURING CURRENT YEAR[a]

Year[b]	*Reported Loss Per Car*[c]	*Estimated Loss Percent*[d]
1929	$63	.58
1930	65	.85
1931	47	1.03
1932	59	1.74
1933	42	.70
1934	50	.72
1935	55	1.08
1936	51	.65
1937	52	1.19
1938	62	2.42

[a] Based on data presented in the National Association of Sales Finance Companies' leaflet, *Composite Experience of Sales Finance Companies and Automobile Dealers, 1938*; the data pertain to repossessions on both new and used cars.

[b] Year in which repossession occurred.

[c] Reported by finance companies in replies to questionnaires sent out by the National Association of Sales Finance Companies, and pertaining only to non-recourse deals.

[d] Estimated as follows: for each year the number of cars financed (as found by the United States Department of Commerce and reported in the Association's leaflet) was multiplied by the percent of cars repossessed (as found by the Association in response to questionnaires); the resulting number of repossessed cars, times the average dollar loss per repossessed car on non-recourse deals, gave an estimate for the total repossession loss in dollars, and this was then expressed in percent of the total dollar volume of retail paper handled in that year by companies reporting to the Department of Commerce. In the conclusion that the resulting repossession loss percentage fairly estimates relative losses on non-recourse deals it is necessarily assumed that recourse and non-recourse paper is repossessed in approximately the same proportion.

The number of companies represented in the Department of Commerce reports varied during this period from 456 to 419; in volume of business these companies are said to represent about 95 percent of the total for all automobile sales finance companies. The National Association figures for the percent of cars repossessed represent a smaller number of companies; their dollar volume amounts, however, to about a fifth to a half of that of the larger group.

tail credit losses on non-recourse deals, for they include only those losses arising from repossession. Also, they are not strictly comparable to the loss percentages illustrative of recourse automobile financing, given in Table 23, as they are computed on a different basis.[13] They suffice to suggest, however, that credit losses of sales finance companies in non-recourse deals consistently and substantially exceed those in recourse financing.

HANDLING OF CREDIT LOSSES

Finance companies following conventional accounting procedure set up the estimated value of repossessed cars in an asset account to which are charged the expenses of repossessing and such expenses as may be entailed in reconditioning. When the cars are sold the selling price is credited to the same account and the loss or profit, if any, is charged to a reserve-for-losses account which has been set up out of the finance charges.

Most companies carry special insurance to protect themselves from losses caused by conversion or confiscation of the collateral and from collision losses not covered by insurance under the financing contract, but any losses resulting either from the lack of such insurance or from unsatisfactory adjustments are charged to the reserve for losses. If there is a conversion, or "skip," the defrauding purchaser is pursued if possible, and there is a sizable percentage of recoveries. The value realized from recoveries is credited to the reserve-for-losses account.

The credit losses of sales finance companies have thus far

[13] The two bases for the computation of loss percentages would give comparable results under conditions of constant volume, but loss percentages figured against current volume tend to understate credit loss experience under conditions of increasing business, and to exaggerate it under conditions of decreasing business, in comparison with percentages that are figured against the volume of paper purchased during the year in which the loss paper originated.

been discussed in terms of losses from retail automobile financing. Credit losses are incurred also on wholesale automobile financing, and although such losses are ordinarily substantially lower than retail credit losses they may attain to considerable proportions in periods of business recession with widespread dealer failures. Retail paper covering diversified lines also entails a measure of credit loss, but since such financing is done largely on a recourse basis, losses are usually very low. Finally, there are credit losses from the discounting of open-account receivables, from industrial financing, small loan financing and any other line of credit business in which the sales finance company may engage.

The usual practice, as has been said, is to charge credit losses to a reserve-for-losses account which is continually fed by a small allocation from each finance charge, but the precise meaning of such reserves and their comparability among companies is never clear. This is due partly to the sharp differences of opinion that prevail as to what constitutes a loss and as to how losses and reserves should be treated in accounting procedure, and partly to the varying proportions of retail instalment financing as against other credit business that different companies engage in.

As to the question of what constitutes a loss, one who has had occasion to review the accounting methods of some two hundred different finance companies has declared that he found among them fifty different methods of computing losses.[14] He cited in illustration a used car financed for $300 with total charges amounting to $60 and a net finance charge (after allowance is made for insurance, dealer's reserve and loss reserve) of $40, making a total note of $360; the car is repossessed within 45 days, without any payments, and sold for $315.

[14] According to a letter received by the National Association of Sales Finance Companies from one of its members; see *Time-Sales Financing*, vol. 2, no. 11 (November 1937) p. 12.

Some finance companies, according to this observer, would show a loss of $45, while other companies would prorate the overall charge to show a loss of anywhere from $5 to $45. Still other companies, he stated, would consider as profit the $15 realized in excess of cash actually advanced, or would consider that they had made a profit of that amount minus interest for 45 days and actual disbursements in connection with the deal. That various methods of accounting in actual use should produce such varying results, ranging from a loss of $45 to a profit of $15, clearly indicates a confused state of accounting practice.

Lack of uniformity in the definitions and accounting methods employed for computing and reporting credit loss experience has resulted in widespread demand in the trade for standardized usage. A committee appointed by the American Finance Conference to study this question[15] has recommended that losses on different types of business be reported separately and computed as a percent of liquidation occurring during a stated period. "Credit losses" it defined as loss on repossessed merchandise sold,[16] plus reconditioning expense and direct selling expense on such merchandise; "other losses" it defined as conversion, confiscation and collision losses, plus the premiums on insurance, and also incidental expenses.

The committee believed that a part of general overhead expenses should be included in computing repossession loss, but doubted whether any agreement could be reached con-

[15] The committee was appointed in 1936 at the suggestion of Arthur W. Newton, Vice President of the First National Bank of Chicago, and its members were: C. F. Cunningham, President of National Discount Company, South Bend, Indiana, chairman; Owen L. Coon, President of General Finance Corporation, Detroit, Michigan; and J. Frank Hudson, Vice President of Interstate Securities Company, Kansas City, Missouri. The committee's report is partly quoted in American Finance Conference, Special Bulletin no. 29 (1938).

[16] Unpaid balance at repossession, minus unearned finance charge, minus actual resale price.

cerning the determination and apportionment of overhead, since there are so many different ideas on this problem; for this reason it recommended that all but direct expenses be excluded. The committee also recognized the apparent inconsistency of charging an insurance premium to a loss account, but considered this necessary in cases where the insurance is provided and paid for by the company; the inclusion of this item by all companies was strongly recommended so that results might be comparable.

5

Credit Standards and Terms

THE procedures just described, regulating the relations between the various parties, help to distribute and minimize the risk that is always present in sales finance as in other types of credit. Risk is further minimized, and to some extent avoided, by maintaining strict standards in judging applications for credit, and, when credit is granted, by stipulating certain requirements concerning repayment. Thus dealers and finance companies have evolved a more or less defined set of facts, bases, rules, principles and ideals which guide them in evaluating the prospective customer's ability and willingness to meet obligations when they are due. It is on the basis of these credit standards that it is decided to whom credit will be granted, how much credit, and on what terms.

CREDIT STANDARDS

There is a long list of standards, not necessarily mutually exclusive, that are given varying degrees of importance in judging applications for instalment credit. Conspicuous in the list are such factors as: collateral, or durability and resale value of commodity; cash selling price of commodity; size of down payment that the buyer-borrower is willing to make; the time he needs in order to repay his debt (length of contract); ratio of monthly payment to monthly income; occupation of buyer-borrower; permanence of employment as indicated by employment record; previous instalment payment record with lender; past debt payment record gener-

ally; extent of present indebtedness, instalment and other; personal character of applicant; and permanence of residence or ownership of home. Information pertinent to some of these items is obtained directly from the contract; other items are covered in the customer's credit application blank; still others necessitate reference to friends, relatives, credit bureaus or business establishments with which the customer has had dealings.

The relative importance attached to these factors varies from one company to another, and varies even more as between the different types of articles financed. The durability and resale value of the commodity itself are unquestionably important factors, since it is an accepted principle of instalment financing that the commodity purchased shall be the security for the loan. The underlying consideration is of course the possibility that repossession and resale will become necessary; in that case the avoidance of loss depends on resale value, and this in turn depends largely on the durability of the commodity. But the importance attached to durability and resale value necessarily varies from one type of commodity to another, roughly in accordance with the original cash selling price. This explains why factors relating to collateral security are given more weight in automobile than in diversified financing. It also goes far toward explaining the role of cash selling price in credit standards; cash price is merely a convenient quantitative measure that dealers and credit men use in appraising the durability and resale value of the collateral.

The importance attached to down payment and length of contract is related both to considerations of collateral security and to considerations of debtor solvency. Down payment determines what proportion of the original loan is still to be realized if repossession becomes necessary, and length of contract determines how quickly this proportion will be decreased by repayments. These are especially important con-

siderations in automobile financing, not only because of the relatively high amount of the loan but also because depreciation of the security is comparatively rapid. Whatever the commodity financed, however, down payment and length of contract have to be considered in relation to the purchaser's income. The higher the down payment the less that remains to be paid out of future income, and therefore there need be less concern if that income is small. But the shorter the contract the heavier is the fixed commitment against income, and therefore a short contract, desirable on one reckoning, may be hazardous on another, and the proper balance must be found. In settling these questions finance companies are well aware that the larger the down payment the greater is the buyer's original equity in his purchase, and the shorter the contract the more quickly he increases his equity; these, too, are important considerations because the more he has to lose the more likely he is to make every effort to avoid default and possible repossession.

An official of an automobile sales finance company declared in an interview on this subject of credit standards that his company had formerly relied primarily on resalability, down payment and length of contract, but the instability of the used-car market in recent years, and also the dealers' demand for smaller down payments and longer contracts, had made it necessary to give increasing consideration to factors concerning the purchaser himself—his income, the ratio of monthly payment to monthly income, his occupation and the permanence of his employment. Another finance company executive declared without hesitation that he regarded the value of the collateral, that is, the car itself, as the most important standard for judging credit risk, and that there must be a down payment of one-third of cash selling price in order to assure sufficient collateral security. Even while he was being interviewed, however, he approved a transaction in which a trade-in allowance of 25 percent of

cash price was accepted as down payment for a new car. This contradiction he justified by citing the applicant's long and steady employment record, and also the fact that the transaction carried the signature of a reliable cosigner. In still another interview a finance company official pointed to an application which had been questioned because the purchaser of the car was nearly seventy years of age and a manual laborer. This transaction too had been approved because of the cosigner.

Thus even in automobile financing, where there is an active resale market and the value of collateral security affords the lender a certain protection, it is customary to consider also the reliability of the purchaser himself and his partners in responsibility. The "human element" can never be entirely disregarded, even when it is not considered in itself a sufficient guarantee.

In the field of diversified financing these "human elements" necessarily take a foremost place in credit standards, for there is less possibility of reselling the collateral promptly at an assured price. Moreover, lower down payments are customary in this field than in automobile financing, and contracts are substantially longer. In view of these circumstances an executive of a diversified finance company declared in an interview that it is very doubtful whether the resale value of diversified commodities purchased on sales finance credit is sufficient, on the average, to enable the lending company to recover its investment. Therefore other criteria, relating to the customer's solvency, have to be given primary emphasis.

In sales financing—whether automobile or diversified—the retailer has the first voice in the granting of credit, and in most cases he assumes a liability in the event of purchaser default. Therefore the retailer's credit standards are more immediately decisive than those of the sales finance company, though the latter must continuously check his judgment,

not only in order to maintain the quality of the paper it handles but also because it has an interest in the credit standing of the retailer.

Table 25 presents the results of a questionnaire on the relative importance attached to different credit standards by various types of retailers. It can be seen that "occupation and permanence of employment" and "past payment record"—both of them factors relating to the customer's creditworthiness rather than to the terms of the contract—were consistently given greatest emphasis by all types of dealers. Automobile dealers, however, accorded relatively less weight to "past payment record" and "additional instalment obligations to other stores" than did those who conducted diversified financing, and they gave, on the whole, relatively more emphasis to standards pertaining to contract terms.

Credit extension by sales finance agencies often depends on the general judgment of the credit man, on the principle that the weight given to various factors depends on the specific case and that no two cases are alike. Not uncommonly, however, a credit rating system is used, by means of which credit men undertake to make their decisions according to more or less mechanical rules.

The usual credit application form contains a blank table which is used in ranking the purchaser as a credit risk. Various items are listed, such as income, permanence of employment, reserve assets, down payment, length of contract, past payment record and so on. Sometimes a general rating of good, fair or poor is entered for each item, and the credit man puts down a final rating which strikes, according to his best judgment, as fair an average of favorable and unfavorable indications as can be made. In other cases a specific grade is entered opposite each item, and the sum of the grades serves as the index of credit risk.

Details are available regarding one such method of risk

TABLE 25

INDEX OF IMPORTANCE ATTACHED TO VARIOUS CREDIT STANDARDS BY 688 RETAIL ESTABLISHMENTS[a]

Credit Standard	*All Establishments*	*176 Department Stores*	*134 Furniture Dealers*	*116 Clothing Dealers*	*56 Automobile, Tire and Accessory Dealers*	*45 Jewelry Dealers*	*43 Lumber Dealers*	*37 Coal and Wood Dealers*	*81 Miscellaneous Stores*[b]
Occupation and permanence of employment	100	100	100	100	100	100	100	100	100
Past payment record	98	93	111	97	78	98	109	97	104
Terms conveniently adjusted to customers' income	48	45	59	40	55	43	51	51	44
Additional instalment obligations to other stores	42	44	47	38	25	49	40	32	48
Terms that will secure largest down payment and fastest liquidation possible	33	31	36	31	42	32	34	20	35
Maturity of contract	16	15	16	15	18	17	15	11	20

[a] Based on a survey conducted by the National Retail Credit Association in cooperation with the National Bureau of Economic Research (Financial Research Program), July and August, 1939. Answers were received from 688 retail establishments situated in 157 cities in the United States and Canada, representing 38 states. These answers were graded by giving 5 points to the credit standards that were ranked first, 4 points to those ranked second, 3 points to those ranked third, 2 points to those ranked fourth, and 1 point to those ranked fifth. Since each type of establishment is represented by a different number of stores, these point-rankings have been converted into an index (with "occupation and permanence of employment" equaling 100), in order that the policies followed by the various types of establishments may be more easily compared. The number of points for "occupation and permanence of employment" was as follows: all establishments 2,906; department stores 803; furniture dealers 497; clothing dealers 510; automobile etc. dealers 257; jewelry dealers 193; lumber dealers 167; coal and wood dealers 152; miscellaneous stores 327.

[b] Comprising 19 hardware, 13 home appliance, 13 music, and 36 shoe, florist, food and stationery establishments.

evaluation employed in automobile financing.[1] This method provides for the analysis of various factors according to a point system, an applicant being a "perfect credit" if he receives 10 points. If he receives from 6 to 10 points the finance company will agree to buy his instalment paper from the automobile dealer without recourse. If his grade is 5 points or less the company will purchase only with recourse or under the repurchase agreement of a responsible dealer. Points are allocated on the following basis: 2 points on previous credit record with others; 2 points on the collateral in the deal; 1 point if the name and address of a relative are provided; 3 points on the record of employment; 2 points on permanence of residence. The system provides for even greater detail. For example, in grading employment record, 1 point is given if the customer's employment in his present job has been longer than six months and less than one year, 2 points if it has been more than one year but less than two years, and 3 points if it has been more than two years. No points are allotted if the employment has been less than six months, and an individual who is self-employed is given no more than 1 point on employment record.

It is particularly significant that employment record is given greater weight than any other factor. The company which developed the system explains and justifies this emphasis on the ground that 53 percent of its repossessions had resulted from loss of employment, and that in three-fourths of those cases the customer had been employed six months or less at the time the contract was purchased.

CONTRACT TERMS

Among the various standards that are used in judging an application for instalment credit, down payment and length

[1] Owen L. Coon, *An Analysis of Automobile Repossessions and the Credit Quotient Method of Credit Analysis*, American Finance Conference, Special Bulletin no. 27 (February 7, 1938) pp. 21 ff.

of contract occupy a rather anomalous position, for although they are dependent to some extent on what the customer will agree to, they are dependent also on the general practice of the finance company and the type of financing that is in question. As has already been emphasized, what the customer will agree to in this regard is an important factor not only in evaluating creditworthiness, but also in determining collateral security. Therefore in fixing its practice concerning contract terms the finance company has an interest in making the range of choice as narrow as competitive requirements will allow.

The terms laid down in the contract include stipulations concerning the finance charge as well as those governing down payment and the length of time over which the payments may be spread, but finance charges involve a different set of questions and they will be discussed in a separate chapter. Down payment and contract length are singled out for consideration here because they both affect and are affected by the customer's ability to fulfil his obligation.

Down payment, which is the amount paid by the instalment buyer to the dealer at the time the sale is made, may consist only partly of cash, the remainder consisting of an allowance made for a trade-in. Such a large percentage of transactions involve a trade-in that it may be said with some truth that the typical instalment sale is not only a sale of a commodity but is also a purchase, by the seller, of another commodity of less value, the purchase price of the second (the trade-in allowance) serving as part payment for the first. Customarily the trade-in allowance is considered as immediate cash and is accepted as, or applied to, the down payment, but in some cases in which the commodity given in trade has little or no resale value the seller insists on cash for the entire down payment, and the trade-in allowance merely reduces the gross price of the article sold.

The trade-in type of sales transaction is most prevalent in the automobile field. Data assembled by the National Association of Sales Finance Companies show that in recent years (1935-38) nearly nine out of ten new-car, and more than half of all used-car, sales—both cash and instalment—have involved a trade-in of another car.[2] Data for cars financed during the same period by a national sales finance company show that in retail instalment transactions eight out of ten new-car sales and more than six out of ten used-car sales involved trade-ins. While total down payments averaged about 45 percent of new-car sales prices and 40 percent of used-car sales prices in trade-in transactions financed through this company, cash payments averaged only about 9 percent for both new and used cars; the balance was trade-in allowance. The instalment transaction is less commonly complicated by the trade-in problem in other types of commodities, but trade-ins are accepted in many furniture and electric appliance deals.[3]

Contract Terms in Automobile Financing

In automobile financing, what came to be known as standard terms with regard to down payment and length of contract were adopted by the executives of 291 finance companies—national, regional and local—at a meeting held in Chicago on December 10 and 11, 1924. The formulation of such terms was suggested by a group of leading bankers in order that the business might be kept on a sound basis from

[2] National Association of Sales Finance Companies, *Composite Experience of Sales Finance Companies and Automobile Dealers, 1938.* The data were obtained by questionnaires sent to dealers with the cooperation of the National Automobile Dealers Association.

[3] A questionnaire to retail furniture dealers, circulated by the National Bureau of Economic Research (Financial Research Program), with the cooperation of the National Retail Furniture Association, indicates that trade-in practice varies widely but that a few stores make trade-in allowances in as many as 75 percent of all deals.

the standpoint of all concerned—individual dealer, finance company, bank, manufacturer and consumer.

For new cars the down payment was set at one-third of purchase price, with the balance payable in 12 equal monthly instalments; for used cars it was set at 40 percent of purchase price, with the balance payable in the same way. During a number of years there was substantial adherence to these standards,[4] but in 1934, during recovery from the depression, considerably easier terms appeared. The relaxation of terms varied in different regions, but was more pronounced in metropolitan areas than in country districts. In some sections terms were frequently 25 percent down, with 24 to 30 months time on new cars and 18 to 20 months on used cars.

Various reasons may be adduced for the increased proportion of substandard automobile paper purchased by sales finance companies during this period of business expansion. Manufacturers and dealers pressed for easier terms in order to stimulate the recovery of automobile sales, and instalment paper tended to go to the finance companies most generous in accommodating them. It is likely that the competitive easing of terms was fostered by the acute rivalry between the recourse companies—factory-controlled or factory-affiliated—and the non-recourse, independent finance companies, which resulted in the formation of a separate association by the latter in 1934 (the American Finance Conference). The comparatively favorable credit experience of sales finance companies during the preceding depression years was still another factor encouraging them to modify standards, and also they were induced to expand volume, even at the competitive sacrifice of standards, by the relative ease and decreased cost of obtaining from commercial banks the funds

[4] According to the National Association of Sales Finance Companies, *op. cit.*, 19 percent of paper had substandard down payments in 1925, and 19 percent ran more than 12 months; by 1927 the figures had fallen to 5 percent and 12 percent respectively; after 1927, however, they gradually increased, and in 1932 were 14 and 22 percent respectively.

needed to carry the instalment paper that they discounted. Finally, rising used-car prices, accompanying the business upswing, tended to increase repossession values and reduce losses, thus encouraging the granting of more liberal terms. This development was rationalized in the trade by the contention that mechanical improvement and increased durability of automobiles, extending their period of usefulness and raising their value as collateral, justified a modification of terms.

During 1936 the rapid expansion of instalment selling, and particularly the easing of terms which had taken place since 1934, began to cause general concern. In November 1936 the American Finance Conference adopted a resolution favoring another standardization and tightening of terms on sales of passenger cars and light delivery trucks east of the Rocky Mountains. On new cars a minimum down payment of one-third of cash selling price, a maximum contract length of 18 months, and equal monthly instalments were proposed. The same terms were suggested for used cars not over two years older than current models; for all other used cars the same down payment was suggested but no more than 12 months was to be allowed for payment. These proposals were reaffirmed by resolution in 1939. In September 1937 the National Association of Sales Finance Companies made the same proposals, and they were reaffirmed by resolution in November 1938.

The trends since 1933 in automobile instalment terms are indicated in Table 26. Of all cars financed during 1933 (dollar volume), only 12 percent involved substandard down payments, but by 1935 the proportion had risen to 34 percent, though it declined thereafter to 21 percent in 1938. The trend toward longer contracts continued through 1937; of all cars financed the proportion granted contracts of more than 12 months' duration rose consistently from 13 percent

TABLE 26

SUBSTANDARD PAPER AS PERCENT OF ALL AUTOMOBILE INSTALMENT PAPER HELD BY REPORTING SALES FINANCE COMPANIES, 1933–38[a]

Year	Substandard Down Payments[b]			Contract Lengths Over 12 Months[c]		
	New	Used	All	New	Used	All
1933	..	..	12	..	..	13
1934	17	21	18	38	15	30
1935	29	43	34	62	24	48
1936	26	27	26	72	35	59
1937	23	24	23	78	53	68
1938	19	23	21	72	51	62

[a] Sales finance companies reporting to the National Association of Sales Finance Companies. See the Association's leaflet, *Composite Experience of Sales Finance Companies and Automobile Dealers, 1938,* covering about 20 percent of the dollar volume of automobiles financed by all automobile sales finance companies.

[b] For new cars less than one-third of cash selling price. For used cars less than 40 percent, up to and including 1935; in 1936-38 one-third applied also to used cars.

[c] The terms established in 1924 set the maximum contract length at 12 months, for both new and used cars. The new standard terms established by the American Finance Conference (1936) and the National Association of Sales Finance Companies (1937) set the maximum at 18 months on new cars and at 12 months on used cars, except for used cars under two years of age, to which the 18-month length applies. In the years 1936-38 the proportions of new-car paper having more than 18 months' duration were 27, 44 and 25 percent respectively.

in 1933 to 68 percent in 1937. Table 27, showing the distribution of automobile instalment paper according to length of contract, gives the picture more exactly for the years 1936-38.

The figures in these two tables reveal a change toward more conservative terms, evident on down payments after 1936 and on contract lengths after 1937. Tabulations based on consolidated reports of twenty leading finance companies reveal the change even more strikingly. Data for these com-

TABLE 27

PERCENTAGE DISTRIBUTION OF AUTOMOBILE INSTALMENT PAPER OF REPORTING SALES FINANCE COMPANIES, 1936–38, BY LENGTH OF CONTRACT[a]

Length of Contract (in months)	*New Cars* 1936	1937	1938	*Used Cars* 1936	1937	1938	*All Cars* 1936	1937	1938
1–12	28	22	28	65	47	49	41	32	38
13–18	45	34	47	32	48	49	40	40	48
19–24	25	39	25	3	4	2	17	25	14
Over 24	2	5	[b]	[b]	1	[b]	2	3	[b]
TOTAL	100	100	100	100	100	100	100	100	100

[a] Taken from the leaflet of National Association of Sales Finance Companies, *Composite Experience of Sales Finance Companies and Automobile Dealers, 1938,* covering about 20 percent of the dollar volume of automobiles financed by all automobile sales finance companies.
[b] Less than 0.5 percent.

panies show that between June 1937 and June 1938 the proportion of contracts bearing a less than one-third down payment declined from 30 to 17 percent for new cars and from 36 to 23 percent for used cars. On new cars contracts extending longer than 18 months declined from 35 to 17 percent, and on used cars contracts of longer duration than 12 months fell from 48 to 45 percent.[5] These changes were due partly to the contraction of business that occurred in the latter part of 1937 and the first half of 1938. Possibly they also reflected the actions of the American Finance Conference in November 1936 and the National Association of Sales Finance Companies in September 1937, formulating new standard terms and advocating strict adherence to them. Recent information indicates, however, a renewed tendency toward more liberal terms since the end of 1938.[6]

[5] Arthur W. Newton, "The Future of Finance Companies" in *Banking,* Journal of American Bankers Association (January 1939) p. 23.
[6] Fred V. Chew, "From Where—To Where," address before the sixth annual convention of the American Finance Conference, November 8, 1939.

Contract Terms in Private Diversified Financing

For instalment purchases of other commodities, such as furniture, household appliances and jewelry goods, there are no standard terms like those for automobiles. This is perhaps to be expected, since for these various goods there is no great uniformity either in the type of retail outlet which sells them or in the type of agency which finances them.

In recent years, however, attempts have been made by different retail associations to check the extension of too liberal terms and to recommend certain sets of standard terms for different commodities. Individual sales finance companies and public utilities sometimes set up their own standard terms, announcing on the rate cards which they give to dealers the minimum down payment and maximum period of contract acceptable to them. They may offer a choice of arrangements, one of which is designated as "standard terms." The rate cards on household appliances, for example, may contain such statements as: "Standard terms for refrigerators —minimum down payment 10 percent; maximum time 30 months. Alternative terms—minimum down payment 5 percent; maximum time 24 months. In no case may down payment or monthly payment be less than $5."

Usually, as in this example, the maximum length of contract varies directly with down payment, that is, the larger the down payment the longer the contract may run. Down payments, expressed as a percent of cash selling price, are on the average very much smaller for diversified than for automobile financing, according to the available statistical material. On this point information from the United States Department of Commerce,[7] although of limited scope and coverage, checks with that available from other sources. It indicates that although automobile dealers (47 establish-

[7] Assembled by M. L. Merriam, Marketing Research Division, Bureau of Foreign and Domestic Commerce, in connection with the *Retail Credit Survey, 1937,* but not included in the published survey.

ments) received down payments averaging 42 percent of cash price in 1936 and 44 percent in 1937, the dealers in other commodities received far less, as follows: department stores (37 establishments) 16 in 1936 and 14 in 1937; furniture stores (47 establishments) 10 in 1936 and 10 in 1937; household appliance stores (8 establishments) 9 in 1936 and 7 in 1937; and jewelry stores (20 establishments) 11 in 1936 and 11 in 1937. There is no way of knowing how much of these down payments was in the form of cash and how much in the form of trade-in or other allowance.

There are necessarily wide variations in contract lengths offered to instalment purchasers of diversified commodities, depending on amount of original cash selling price. For example, time-payment buyers of radios generally place 10 percent of the cash price as a down payment, and pay off the balance in 12 or 18 monthly instalments, whereas refrigerator buyers, although typically placing 10 percent down, usually take as long as 24 to 36 months, perhaps even 48 to 60 months, to pay off their instalment obligation.

It has already been pointed out that contract terms in the automobile field held fairly steady from 1925 until 1934, but that considerably easier terms developed in the expansion period 1934-37. There are no comprehensive data indicative of the course of terms in other lines, but trade reports indicate that they showed a corresponding trend. Table 28, based on different sources, compares the typical down payment and length of contract prevailing in the instalment financing of seven different commodities in 1925 and in 1938. Down payment percentages are shown to have been considerably smaller in 1938 than in 1925; for furniture, sewing machines and jewelry-store goods contract length remained much the same, but for four commodities—radios, refrigerators, vacuum cleaners and washing machines—contracts were considerably longer in 1938 than in 1925, in spite of notable reductions in the unit prices of these goods.

TABLE 28

TYPICAL CONTRACT TERMS IN THE FINANCING OF SEVEN DIFFERENT COMMODITIES, 1925 AND 1938

Commodity	*1925*[a]		*1938*[b]	
	Down Payment (in percent)	Length of Contract (in months)	Down Payment (in percent)	Length of Contract (in months)
Furniture	15	18	10	12 & 18
Jewelry-store goods	20	10	10	10 & 12
Radios	25	6	10	12 & 18
Refrigerators	15	18	10	24 & 30
Sewing machines	10	18	10[c]	18[c]
Vacuum cleaners	15	9	10	12 & 18
Washing machines	10	12	10	12 & 18

[a] From Milan V. Ayres, "Installment Selling and Its Financing," unpublished pamphlet (1926).

[b] From M. L. Merriam, *Retail Credit Survey, 1938,* Marketing Research Division, Bureau of Foreign and Domestic Commerce, U. S. Department of Commerce.

[c] From J. Anton Hagios, "Credit Terms as an Element in Merchandising Competition," address before American Marketing Association, December 28, 1939.

For the period of business expansion, 1934-37, during which automobile contract terms showed the greatest liberalization, detailed information on other commodities is available only for one organization—a large sales finance company whose diversified financing consists mainly of refrigerator paper. It may fairly be assumed that these contract terms, shown in Table 29, substantially reflect the main trends in diversified financing. The proportion of articles for which the down payment was less than 10 percent of cash price increased steadily from 14 percent in 1934 to 31 percent in 1937 (though it dropped to 14 percent in 1938). The proportion of articles for which the length of contract was over 18 months increased from nearly 70 percent in 1934 to 84.5 percent in 1936, but fell slightly in 1937 (and again in 1938).

TABLE 29

PERCENTAGE DISTRIBUTION OF NEW RETAIL DIVERSIFIED FINANCING OF A LARGE SALES FINANCE COMPANY, 1934–38, BY DOWN PAYMENT AND LENGTH OF CONTRACT[a]

Year	Down Payment: Under 10 Percent			10–20 Percent			20 Percent and Over			Total		
	Length of Contract: 0–18 Months	Over 18 Months	Total	0–18 Months	Over 18 Months	Total	0–18 Months	Over 18 Months	Total	0–18 Months	Over 18 Months	Total
1934	1.6	12.5	14.1	10.9	40.6	51.5	17.9	16.5	34.4	30.4	69.6	100.0
1935	2.1	22.6	24.7	8.9	36.5	45.4	14.8	15.1	29.9	25.8	74.2	100.0
1936	1.3	25.9	27.2	5.4	43.3	48.7	8.8	15.3	24.1	15.5	84.5	100.0
1937	1.5	29.2	30.7	5.6	38.6	44.2	9.7	15.4	25.1	16.8	83.2	100.0
1938	.9	13.1	14.0	6.4	46.8	53.2	11.5	21.3	32.8	18.8	81.2	100.0

[a] Based on data supplied by the company. The number of contracts financed ranged in these years from approximately 65,000 to nearly 118,000. Information on the kinds of articles and number of each is not available, but it is known that the great bulk of the diversified financing of this company is for mechanical refrigerators.

Various reasons may be adduced for the easing of instalment contract terms which is indicated in Table 29 and which seems to have occurred generally in diversified financing. In this field, as in automobile financing, the most obvious reason was the post-depression effort to stimulate a recovery of sales. A special factor in the appliance field was the merchandising promotion of the larger utility companies with the object of increasing the use of appliances and therefore the domestic consumption of electricity and gas. Ten years ago utilities offered very liberal terms on the more expensive appliances, and in this expansion period they extended these terms to lower-priced appliance items and further liberalized terms on the more costly items. A third competitive element arose from the establishment of the Electric Home and Farm Authority in 1934, as an appliance financing agency, and from its introduction of sales finance plans for electric appliances on the basis of three to five years in which to pay. The creation of the Federal Housing Administration in 1934, and its insurance from June 1935 to April 1936 of loans for the purchase of chattel equipment, provided an additional stimulus to the easing of credit terms in diversified financing.

As was mentioned above, however, various retail associations have taken active steps within the last few years to restrict the terms offered in diversified financing. At their annual conventions in the summer of 1937 the National Retail Credit Association, the Credit Management Division of the National Retail Dry Goods Association and the National Retail Furniture Association all adopted resolutions calling for shortened contracts and a minimum down payment of 10 percent. Typical of this movement was the recommendation by the National Retail Credit Association of maximum contract lengths, as follows: electric refrigerators, 24 months; furniture, 18 months; radios, 12 months; washing machines, 12 months; stoves and ranges, 18 months. In September of

that same year the major sales finance companies, and also some of the smaller companies, announced a schedule in which refrigerator terms were changed from 36 to 30 months and terms on other appliances were also restricted. A number of these sales finance companies favored a reduction from 36 to 24 months, but the 30-month maximum was decided upon in order not to curtail sales.

Contract Terms in Electric Home and Farm Authority Financing

The Electric Home and Farm Authority does a very small volume of business in comparison with the total volume of diversified financing, but its practices with regard to down payment and length of contract deserve special attention because its entrance into the field of sales financing is alleged in the trade to have been partly responsible for the liberalizing of terms by private agencies, and also because data on its operations are much more complete than available data on private agencies.

The minimum down payment in EHFA financing was at first expected to approximate the monthly payment, and consequently it was frequently under 5 percent of the cash selling price of the merchandise. The percentage was gradually revised upward, without altering, however, the principle of a small down payment. In July 1938 the minimum down payments permitted on the various types of consumer appliances which EHFA had approved for financing at that time were 5 percent for refrigerators, ranges, water heaters, clothes ironers, washing machines, vacuum cleaners, dishwashers and waste disposal units, and 10 percent for attic ventilating fans, radios and portable space heaters.[8] The trend toward down payments of 10 percent and more is in-

[8] From EHFA Form no. 248, revised, July 28, 1938. A 5 percent minimum down payment was required on such farm equipment items as water pumps, milk coolers, cream separators, farm motors, and a 10 percent minimum on feed grinders and milking machines.

dicated in Table 30. But although the proportion of down payments of 2½ (the minimum) to 10 percent decreased sharply between 1934 and 1938, for the entire period 45 percent of all contracts had down payments within this range; 35 percent had down payments between 10 and 20 percent. During the entire period 1934-38 less than 4 percent of the contracts had down payments of 40 or more percent, and it may be surmised that in many cases these were associated with trade-ins. On all commodities financed during this four-year period the average down payment was 15 percent; the average increased each year, from 12 percent in 1934-35 to 16 percent in 1937-38.

The maximum length of contracts financed by EHFA is determined by the type and number of appliances bought, although requirements as to minimum amount of note ($40)

TABLE 30

PERCENTAGE DISTRIBUTION OF CONTRACTS FINANCED BY ELECTRIC HOME AND FARM AUTHORITY, FISCAL YEARS 1934–38, BY DOWN PAYMENT[a]

Down Payment[b]	*1934–35*[c]	*1935–36*	*1936–37*	*1937–38*	*All Years*	*Cumulative Percent*
2½–10	61.5	54.9	51.4	36.7	44.6	44.6
10–20	28.1	30.3	31.9	37.6	34.5	79.1
20–30	6.2	8.4	10.1	14.6	12.1	91.2
30–40	2.4	3.5	4.0	6.9	5.4	96.6
40–75	1.8	2.9	2.6	4.2	3.4	100.0
TOTAL	100.0	100.0	100.0	100.0	100.0	
Average Down Payment	12%	13%	14%	16%	15%	
Number of Contracts	4,886	7,648	22,460	39,101	74,095	

[a] Based on data supplied by EHFA.
[b] Expressed in percent of cash selling price. Each level is inclusive of the lower figure and exclusive of the higher.
[c] Includes 142 contracts purchased in June 1934.

and minimum monthly instalment ($1.50) affect duration slightly. As is shown in Table 31, the average length of contract tended to decrease somewhat between June 1934 and June 1938, although it showed a slight rise in 1935-36; the average for the entire period was 30.6 months. In the first two years of the Authority's activities considerably more than half of its contracts were for 36 months, but by 1937-38 only about 37 percent were of this length and nearly one-fourth were for 24 months. Throughout the period there was a consistent increase in the proportion of contracts running for 6 to 18 months.

Before July 1938, as this table indicates, a maximum con-

TABLE 31

PERCENTAGE DISTRIBUTION OF CONTRACTS FINANCED BY ELECTRIC HOME AND FARM AUTHORITY, FISCAL YEARS 1934–38, BY LENGTH OF CONTRACT[a]

Length of Contract[b]	*1934–35*[c]	*1935–36*	*1936–37*	*1937–38*	*All Years*	*Cumulative Percent*
6	.3	.4	.5	3.1	.7	.7
12	3.3	4.6	7.7	13.1	9.9	10.6
18	2.7	5.0	6.1	9.6	7.6	18.2
24	20.2	14.6	23.8	23.8	22.7	40.9
30	7.2	5.8	2.7	6.6	5.4	46.3
36	61.1	64.1	47.0	37.2	44.5	90.8
48	5.2	5.5	5.8	4.0	4.8	95.6
60	..	..	6.4	4.6	4.4	100.0
TOTAL	100.0	100.0	100.0	100.0	100.0	
Average Length of Contract	32.4	34.4	32.1	29.2	30.6	
Number of Contracts	4,886	7,648	2,460	39,101	74,095	

[a] Based on data supplied by EHFA.

[b] Expressed in months. Approximately 98 percent of the contracts had the exact length indicated; those with other lengths have been included in the next higher level.

[c] Includes 142 contracts purchased in June 1934.

tract length of 60 months was permitted on some purchases, but at that time maxima for different types and combinations of consumer appliances were formulated as follows:[9] 18 months for radios, attic ventilating fans, portable space heaters; 24 months for washing machines, vacuum cleaners, dishwashers, waste disposal units; 36 months for refrigerators, ranges, water heaters, clothes ironers; 48 months for combinations of two or more appliances. These terms apply only to new commodities; used commodities, otherwise eligible, have maximum terms of 12 to 24 months, but used ventilating fans, radios and portable space heaters cannot be financed.

The minimum monthly payment permitted by EHFA is $1.50. In the calendar year 1937, when 33,089 contracts were purchased, 90 percent called for monthly payments of less than $8 (34 percent for payments of $1.50 to $4, and 56 percent for payments of $4 to $8). Of the total number 7 percent were in the $8-12 range, 2 percent in the $12-16 range and only 0.9 percent carried monthly payments of $16 to $20.

Comparative Contract Terms in Diversified Financing

For a comparison of the terms of different organizations in the field of diversified financing, the best available standard is mechanical refrigerators. Table 32, giving the distribution, according to terms allowed, of refrigerators financed during 1937, shows that EHFA granted both smaller down payments and longer contracts than did the large private company cited above. Of the latter's contracts only 33 percent, but of EHFA contracts 51 percent, allowed down payments of less than 10 percent of cash price. This difference

[9] Maximum lengths of contract for farm equipment items were: feed grinders, 24 months; milking machines, 30 months; water pumps, milk coolers, cream separators and farm motors, 60 months.

TABLE 32

PERCENTAGE DISTRIBUTIONS OF REFRIGERATOR INSTALMENT CONTRACTS FINANCED BY ELECTRIC HOME AND FARM AUTHORITY AND BY A LARGE PRIVATE SALES FINANCE COMPANY, 1937, BY DOWN PAYMENT AND BY LENGTH OF CONTRACT

Down Payment[a]	*Distribution of Contracts*		*Length of Contract*[d]	*Distribution of Contracts*	
	EHFA[b]	Private Co.[c]		EHFA[b]	Private Co.[c]
Under 10	50.9	33.2	1–12	5.8	8.5
10–20	30.3	45.8	13–24	16.3	26.8
20–30	11.8	12.6	25–30	4.5	15.4
30–40	4.3	5.3	31–36	73.4	49.2
40 & over	2.7	3.1	Over 36	. .	.1
TOTAL	100.0	100.0	TOTAL	100.0	100.0

[a] Expressed in percent of cash selling price. Each level is inclusive of the lower figure and exclusive of the higher.
[b] Based on data supplied by EHFA, covering 14,632 contracts.
[c] Based on data supplied by the company, covering 101,111 contracts.
[d] Expressed in months.

was almost compensated, however, by the difference between the two organizations' contracts with 10-20 percent down payments: 46 and 30 percent, respectively. Thus the respective proportions of contracts calling for down payments of more than 20 percent were about the same.

The differences in regard to contract lengths were more striking. Of EHFA contracts 73 percent were for more than 30 months, whereas only 49 percent of the private company's contracts exceeded that length. For each classification of contract length up through 30 months EHFA had a smaller proportion of paper than did the private company.

Table 33 gives available averages on refrigerator terms from 1934 through 1938 for these two agencies and also for another large private sales finance company (B); it shows a rising tendency in the down payments extended by EHFA

TABLE 33

AVERAGE DOWN PAYMENT AND LENGTH OF CONTRACT IN REFRIGERATOR INSTALMENT CONTRACTS FINANCED BY ELECTRIC HOME AND FARM AUTHORITY, AND BY 2 LARGE PRIVATE SALES FINANCE COMPANIES, 1934–38[a]

Year	*Average Down Payment*[b]			*Average Length of Contract*[c]		
	EHFA[d]	Co. A.	Co. B.	EHFA[d]	Co. A.	Co. B.
1934	8.8	18.7	..	33	21	..
1935	11.3	16.2	..	33	23	..
1936	13.0	14.4	..	32	29	25
1937	14.0	14.4	13	32	29	26
1938	15.6	16.8	17	31	25	23

[a] Based on data supplied by EHFA and by the two companies.
[b] Expressed in percent of cash selling price.
[c] Expressed in months.
[d] Averages for 1934, 1935 and 1936 are for all types of appliances, and therefore are not precisely comparable with those of Company A; about half of these contracts, however, were for refrigerators, and the trend that they show is the same as that for refrigerator contracts alone. Averages for 1934 are for the last half of the year, and those for 1938 are for the first half of the year.

and a falling tendency in those extended by the first private company (A). During 1937 and 1938, the only years for which down payment data from all three agencies are available, the averages do not differ substantially. In length of contract EHFA averages show a declining tendency throughout the period, and those of the two private agencies show a rising tendency through 1937 but a sharp contraction in 1938. The tightening of terms in 1938, evident also in Table 29, reflected the mounting sentiment among dealers and finance companies that liberalization of terms had been carried too far. That it also reflected the relatively poor business conditions prevailing in 1938 is indicated by the similarity of tendencies evident in EHFA contract terms and in those of private companies, for the former agency made no change in this year regarding down payments and contract lengths.

6

Repossession Experience: Automobiles

OUT of any mass of instalment deals some will become delinquent, and of these some will necessitate refinancing or eventual repossession of the article financed. All three sources of difficulty entail costs to the retailer or his finance company, either in increased collection expense or in actual loss. But in instalment sales financing the most convenient test of the effectiveness of credit procedures, standards and terms is experience in regard to repossessions.

In this matter different finance companies will necessarily have different experience. Some will aim to control repossessions as closely as possible; others will not object to a greater number, providing financing charges are high enough to cover costs; still others will emphasize volume and its economies as a compensation for the assumption of greater risk. Also, much will depend on the type of finance business conducted—recourse or repurchase business, with repossession risk shared by the dealer, or non-recourse business with the full risk assumed by the finance company.

It must not be forgotten that it is through the retail dealer that the sales finance company serves consumers. The dealer is the first judge of a consumer's creditworthiness; the sales finance company merely has the right of a credit veto, though for reasons of competition it must stand ready to take whatever paper a creditable dealer offers, at least within limits, insisting or not, in all or special cases, on dealer participation in the risk. Total repossession experience, in a sense, reflects

the composite performance of a system of consumer financing in which some unfavorable credit experience is unpredictable and inevitable, some predictable but for one reason or another unavoidable, and some predictable but deliberately not avoided.

The analysis contained in this and the following chapter represents a survey of the repossession experience of the finance companies themselves, rather than a discussion of what repossession implies for the consumer or for the general functioning of the system of distribution. In most cases, of course, the buyer who must relinquish his purchase because he cannot complete payment for it suffers a financial loss as well as a deprivation of what he has come to consider as his property—though it may sometimes be possible that his use of the good, before its repossession, was commensurate with the amount he had invested in it up to that time. The extent of his loss, however, the reasons for it, the effects it may have on his financial condition, and the discovery of standards by which it might have been avoided, are dependent on his personal situation. Some of the answers to such questions can be inferred from the following analyses of company records. Complete answers could be reached only by surveying individually the thousands of buyers whose purchases have been repossessed.

MEASURES OF REPOSSESSION EXPERIENCE

Probably the commonest and most easily understandable measure of unfavorable credit experience in sales financing is the repossession ratio—the average number of repossessions per hundred articles financed. This measure is not entirely adequate, for it fails to indicate the actual loss resulting from repossessions. Loss can be indicated by the repossession loss ratio—the average dollar losses from repossessions per hundred dollars of finance paper handled. But this ratio is

ambiguous because of the variation in the methods of establishing the amount of loss; the latter may or may not include indirect expenses. Moreover, apparent repossession loss ratios differ substantially as between recourse and non-recourse companies. A recourse company includes only those losses which it has to bear itself, and excludes those it can transfer back to the dealer. A non-recourse company may include only direct losses resulting from repossessions, but it may include indirect costs as well. And both types of companies may include other losses, such as those due to collision, "skip" and the like, where no actual repossession occurs, or those due to adjustments or miscellaneous causes.

Because of the difficulties involved in the repossession loss ratio the following discussion will make use of the repossession ratio as the measure of repossession experience. In most circumstances the pattern of repossession experience may be expected to be the same whether measured by one ratio or the other: one would normally expect a high repossession ratio to be associated with a high repossession loss ratio.

In several instances the repossession ratios have been reformulated in an "index of repossession experience," in order to indicate more clearly the relative significance of differences. This has been done by calculating each repossession ratio as a percent of the average repossession ratio, and subtracting 100. The result shows the extent to which each ratio deviates from the average of all ratios, a plus value indicating worse than average and a minus value indicating better than average.

The intention of this analysis is to relate repossession experience to as many relevant factors affecting it as available data permit. Such factors include down payment, length of contract, price, age of commodity purchased and number of payments made, as well as the immediate reasons for repossession. A complete analysis should relate repossession experience to such purchaser factors as income, occupation, age

and other relevant characteristics, but data for such a study are as yet unavailable.

CHARACTERISTICS OF THE DATA

The data for the following analysis of automobile repossession experience were taken from the records of a single company, but one which operates throughout the country and handles a substantial percentage of all automobile finance paper written in the United States. It must not be assumed that the experience of this single organization—which will be referred to hereafter as the source company—is altogether typical of automobile sales financing in general, but it is safe to say that any relationships, tendencies and patterns which are generally prevalent in automobile repossession experience are to be found in the extremely comprehensive records of this company.

In considering these figures it should be borne in mind that retail dealers and finance company credit men have come to know from long practice that certain factors affect the likelihood of repossession, and that these factors naturally influence their selection of credit risks. Any quantitative data on repossession experience necessarily reflect the prior judgments of dealers and credit men, and these judgments reflect in turn their credit standards—a more or less defined set of facts, rules or principles that are used in deciding to whom credit will be granted, and how much. Conclusions drawn from such data are therefore subject to limitations; it is always possible that the relationship between repossession experience and some relevant factor has been compensated by these selective activities, or even that it has been overcompensated, the relationship shown being thus the reverse of what it might have been without such sifting.

The data on which the following analysis is based cover the repossession experience of the source company on cars

financed during the years 1933-36. The repossessions are calculated as of December 31, 1937; the majority, but not all, of the contracts written in 1936 had been terminated by this date.[1] Since our primary interest is in the general pattern, and since in conformity to the pattern one year shows no striking difference from another, we have taken the average for the period.

The source company's data cover a total of 4,064,666 passenger-car contracts financed at retail during the years 1933-36. Of these, 1,804,607 were for new cars and 2,260,059 were for used cars. The principal features of this body of contracts averaged as follows, in absolute amount and in percent of cash selling price:

	New Cars		*Used Cars*		*All Cars*	
Cash selling price	$809	100%	$314	100%	$534	100%
Down payment	344	43	125	40	222	42
Original unpaid balance	465	57	189	60	312	58
Combined finance charge and insurance premium	77	10	43	14	58	11
Amount of note	542	67	232	74	370	69
Monthly payment[2]	32	4	18	6	25	5
Length of contract	16.7 months		13.0 months		14.6 months	

REPOSSESSION EXPERIENCE ACCORDING TO NUMBER OF INSTALMENTS PAID

It is well known that repossessions occur most frequently within the first few months after contracts are written, a fact which explains the especially intensive collection efforts that are usual in these months. Table 34 shows that about half of new-car repossessions and seven out of ten used-car repossessions occur before four payments are made. Almost eight out of ten new-car and over nine out of ten used-car

[1] In the following tabulations renewals are counted as repossessions.
[2] Obtained by dividing average amount of note by average length of contract.

TABLE 34

PERCENTAGE DISTRIBUTION AND CUMULATIVE PERCENTAGE OF REPOSSESSIONS, 1933–37, ON NEW AND USED CARS FINANCED DURING 1933–36, BY NUMBER OF INSTALMENTS PAID[a]

Number of Instalments Paid	*New-Car Repossessions*		*Used-Car Repossessions*	
	Percentage Distribution	Cumulative Percentage	Percentage Distribution	Cumulative Percentage
0	13.5	13.5	23.0	23.0
1	12.1	25.6	18.6	41.6
2	12.7	38.3	16.4	58.0
3	11.9	50.2	13.3	71.3
4	10.7	60.9	9.7	81.0
5	9.2	70.1	7.0	88.0
6	7.4	77.5	4.7	92.7
7	5.8	83.3	3.0	95.7
8	4.4	87.7	1.9	97.6
9	3.6	91.3	1.1	98.7
10 & over	8.7	100.0	1.3	100.0
TOTAL	100.0		100.0	

[a] Based on data supplied by a large sales finance company, covering 57,739 new-car and 354,052 used-car repossessions. The repossessions are classified according to the year in which they took place and not according to the year in which the transaction originated.

repossessions occur before seven payments, and nine out of ten new-car and practically all used-car repossessions come before the tenth payment. For new cars cumulative repossession percentages are consistently lower than they are for used cars, showing that repossessions on the latter typically occur earlier than those on new cars. This is partly explainable by the generally shorter duration of used-car contracts.

CONTRACT TERMS AS FACTORS IN REPOSSESSION

The role of standard terms covering down payment and length of contract in automobile financing has already been

discussed. The reason why the trade is interested in such terms is attested by the relationship of the repossession ratio to various down payments and lengths of contract. Table 35 indicates that for both new and used cars the repossession ratio declines sharply and consistently as the down payment increases. For both groups it is substantially higher than average for down payments of less than 35 percent of cash selling price, about average in the 36-40 percent down payment level and less than average when down payment is above 40 percent. This fully confirms the common belief in automobile circles that the more a purchaser pays down, that is, the greater his initial equity, the lower the probability that he will fail to complete his payments.

TABLE 35

REPOSSESSION EXPERIENCE, 1933–37, ON NEW AND USED CARS FINANCED DURING 1933–36, BY DOWN PAYMENT[a]

Down Payment (in % of cash selling price)	*Repossession Ratio*[b]		*Index of Repossession Experience*[c]		*% Distribution of All Cars Financed*	
	New Cars	Used Cars	New Cars	Used Cars	New Cars	Used Cars
Under 20	7.8	19.7	+188.9	+69.8	1.6	1.6
20–29	6.4	18.4	+137.0	+58.6	10.8	11.1
30–32	4.9	16.4	+ 81.5	+41.4	6.4	8.4
33–35	3.9	14.5	+ 44.4	+25.0	23.9	25.5
36–40	2.5	11.8	− 7.4	+ 1.7	12.3	21.3
41–49	1.2	7.7	− 55.6	−33.6	17.0	16.2
50 & over	.4	3.4	− 85.2	−70.7	28.0	15.9
ALL CARS	2.7	11.6			100.0	100.0

[a] Based on data supplied by a large sales finance company, covering 1,804,607 new-car and 2,260,059 used-car contracts.

[b] Number of repossessions per hundred cars financed.

[c] Obtained by calculating each repossession ratio as a percent of average repossession ratio and subtracting 100; the result shows each level's deviation from the average of all levels, the plus indicating worse than average and the minus indicating better than average.

TABLE 36

REPOSSESSION EXPERIENCE, 1933–37, ON NEW AND USED CARS FINANCED DURING 1933–36, BY LENGTH OF CONTRACT[a]

Length of Contract (in months)	*Repossession Ratio*[b]		*Index of Repossession Experience*[c]		*% Distribution of All Cars Financed*	
	New Cars	Used Cars	New Cars	Used Cars	New Cars	Used Cars
1– 5	1.1	11.6	−59.3	.0	3.3	3.2
6–11	2.3	15.1	−14.8	+30.2	8.2	23.9
12	1.8	11.1	−33.3	− 4.3	31.1	59.8
13–17	3.5	9.2	+29.6	−20.7	4.0	3.3
18	3.2	6.5	+18.5	−44.0	45.5	9.3
Over 18	3.7	8.8	+37.0	−24.1	7.9	.5
ALL CARS	2.7	11.6			100.0	100.0

[a] Based on data supplied by a large sales finance company, covering 1,804,607 new-car and 2,260,059 used-car contracts.
[b] See Table 35, footnote b.
[c] See Table 35, footnote c.

Table 36 shows that for new cars the shorter the duration of contract the smaller the repossession ratio—again a finding that the automobile trade affirms. One would expect this relationship to be consistent for both new and used cars, since a shorter contract increases owner's equity more rapidly, and also reduces the period in which some untoward event may prevent a completion of the obligation. The present table indicates that, on the contrary, the used-car repossession ratio varies inversely with length of contract. This should not, however, be understood to mean that in the financing of used cars a longer contract usually provides a better risk. It means, rather, that dealers and finance company credit men are so well aware of the possible hazard in granting the longer contracts on used cars that customers receiving them are selected with special care. In this table the figures on the percentage distribution of all cars financed show that con-

tracts of 12 months or less are required of seven-eighths of all used-car buyers but of less than half this proportion of new-car buyers. Also, as will be shown presently, contracts on the lower-priced, higher-risk used cars are conspicuously shorter than on the more costly used cars of more recent manufacture.

CASH SELLING PRICE AS A FACTOR IN REPOSSESSION

Only for used cars are data available on the relationship between repossession and cash selling price. Table 37, which gives the source company's repossession ratio for eleven price

TABLE 37

Repossession Experience, 1933–37, on Used Cars Financed During 1933–36, by Cash Selling Price[a]

Cash Selling Price[b]	*Repossession Ratio*[c]	*Index of Repossession Experience*[d]	*% Distribution of All Cars Financed*
Under $100	20.9	+79.5	4.2
100–200	16.3	+40.2	27.8
200–300	12.0	+ 2.8	24.2
300–400	9.6	−17.5	17.2
400–500	7.1	−39.0	12.9
500–600	6.0	−48.6	7.3
600–700	6.0	−48.7	3.4
700–800	5.7	−50.9	1.5
800–900	6.0	−48.7	.7
900–1000	5.9	−49.7	.3
1000 & over	6.8	−41.9	.5
All Cars	11.6		100.0

[a] Based on data supplied by a large sales finance company, covering 2,260,059 used-car contracts.
[b] Each level is inclusive of the lower figure and exclusive of the higher.
[c] See Table 35, footnote b.
[d] See Table 35, footnote c.

levels, shows that for used cars the most unfavorable repossession experience is with those of lower price. As used-car prices increase to $500 there is a distinct tendency for repossessions to diminish; above the $500 level there is no appreciable change.

On the basis of this evidence one might designate used cars selling for less than $300 as bad risks subject to a relatively high probability of repossession, those selling at between $300 and $500 as an intermediate risk group, and those selling for prices upward of $500 as a relatively good risk. As has been shown in earlier tables of this chapter, the repossession ratio for used cars tends to run materially higher than that for new cars, averaging more than four times as much, according to source company data for 1933-36. Even for the low-risk, high-priced used cars, that is, those selling for $500 and over, the repossession ratio is more than twice the average for all new cars.

The tendency for repossession experience to be better for higher- than for lower-priced used cars is readily understandable. For one thing, those who buy the higher-priced cars have made a higher absolute cash investment, and therefore when it is possible to continue payments, even though it is not easy, they are likely to be much less inclined to let their cars go. Furthermore there is much greater likelihood of purchaser dissatisfaction with the lower-priced cars, which are necessarily the oldest and mechanically the poorest. Supplementary data, not tabulated here, reveal a fairly pronounced tendency for repossessions to increase with age of car.

CONTRACT TERMS AND PRICE AS COMPOSITE FACTORS IN REPOSSESSION

That repossession experience varies by down payment, contract length and cash selling price has already been indicated. It remains to consider these three factors together so that

their various interrelationships may be studied. Sales finance companies seldom tabulate their repossession data by more than one or two basic factors, but one comprehensive tabulation of the source company's used-car repossession experience is available for 1937. This is given in Table 38, and it provides both a summary and an elaboration of observations already made. The table confirms, for example, the tendency for used-car repossessions to decrease as down payment increases; with one minor exception[3] this tendency is present throughout, for all prices and for all contract lengths. Similarly, the tendency for used-car repossessions to decrease as price increases is shown here to be consistent for all down payment percentages and for all contract lengths.

This more ramified tabulation helps also to explain the apparent paradox that was evident in the direct relationship between length of contract and used-car repossession experience. It is true that when price is disregarded the repossession ratio declines with longer contracts, regardless of what the down payment may be. But in each of the three price levels itemized here the ratios for "all cars" tend to move in the expected direction as contracts become longer. Still more significant is the indication that longer contracts are granted mainly for higher-priced cars. Approximately a third of the cars financed in this period carried contracts running more than 12 months, and of these cars 80 percent sold for $400 or more, a price group that was conspicuously better than any other in its repossession record.

The importance of using a detailed analysis, such as is presented in Table 38, as a means of confirming the general tendencies revealed by simple relationships, may be illustrated by reference to the problem of finance charges. Let us

[3] The exception is for cars costing less than $200, with contracts running longer than 12 months. Here the repossession ratio on contracts calling for 34-40 percent down payment is slightly higher than on those calling for less than 34 percent; even on these contracts, however, there is a decrease from the lowest to the highest down payment level.

TABLE 38

REPOSSESSION EXPERIENCE, JANUARY 1937–JUNE 1938, ON USED CARS FINANCED IN 1937, BY CASH SELLING PRICE, DOWN PAYMENT AND LENGTH OF CONTRACT[a]

Cash Selling Price	*Length of Contract* (in months)	REPOSSESSION RATIO				% DISTRIBUTION OF ALL CARS FINANCED			
		Down Payment Percentage				*Down Payment Percentage*			
		Under 34	34–40	41 & Over	All Cars	Under 34	34–40	41 & Over	All Cars
Under $200	Under 9	28.3	22.8	15.2	22.8	2.4	2.1	1.7	6.2
	9–12	25.9	20.7	13.9	22.1	9.7	6.9	3.3	19.9
	Over 12	32.1	33.8	26.8	32.0	b	b	b	b
	All cars	26.4	21.2	14.7	22.3	12.1	9.0	5.0	26.1
$200–400	Under 9	21.7	20.1	7.8	13.9	.4	.4	.8	1.6
	9–12	21.0	16.0	6.8	15.1	9.5	8.4	7.7	25.6
	Over 12	19.1	13.5	7.1	16.2	4.0	1.9	.7	6.7
	All cars	20.4	15.7	6.9	15.3	13.9	10.8	9.2	33.9
$400 and over	Under 9	11.8	10.3	3.4	6.3	.3	.3	.9	1.5
	9–12	14.2	10.0	2.0	6.6	2.7	2.9	6.9	12.5
	Over 12	12.4	7.4	2.4	8.5	11.7	7.9	6.4	26.0
	All cars	12.9	8.1	2.3	7.8	14.7	11.1	14.2	40.0
All cars	Under 9	26.2	21.1	10.4	18.9	3.0	2.8	3.5	9.3
	9–12	22.4	16.8	6.2	15.6	21.9	18.2	17.9	58.0
	Over 12	14.2	8.7	2.9	10.1	15.8	9.8	7.1	32.7
	All cars	19.5	14.6	5.9	14.1	40.7	30.8	28.5	100.0

[a] Based on data supplied by a large sales finance company, covering 815,158 used-car contracts; repossession ratios calculated as of June 30, 1938.
[b] Less than 0.1 percent.

suppose a finance company concluded that if it used a given schedule of charges it could not afford to finance any group of automobiles on which the repossession ratio was more than 16 out of every hundred cars financed. Table 38 shows that the used-car repossession ratio averages 22 for cars costing under $200, 19 for contracts running less than 9 months, and 20 for all cars with down payments of 34 percent and under. The company might conclude that all of these groups present unsatisfactory risks, except on the basis of a premium finance charge. Thus such a charge would be required on some 57 percent of used-car contracts. If, however, the company examined the record in more detail it would find that the used-car contracts which would prove unsatisfactory on the basis of scheduled charges would be confined to four groups: those in the price-class under $400 with down payments under 34 percent; those in the price-class under $200 with down payments of 34 to 40 percent; those in the price-class under $200 with contract lengths over 12 months; those in the $200-400 price-class with contract lengths under 9 months and no more than 40 percent down payment. Thus, on the basis of past repossession experience, the finance company could expect to subject about 65 percent of the contracts to its scheduled finance charge, and to require a premium charge on only 35 percent of its used-car contracts.

This illustration merely serves to show that care must be used in applying experience data to practical problems. Under a given rate schedule down payment and other requirements may be profitably relaxed when other indications are satisfactory, and they may have to be tightened when other indications are unsatisfactory.

IMMEDIATE REASONS FOR REPOSSESSION

In addition to the significance of contract terms and price as factors in repossession, it is important to understand the im-

mediate reasons that make repossession necessary. But any analysis of repossession experience according to this classification is bound to encounter difficulties. For one thing, the very term "reason for repossession" is somewhat ambiguous. Other terms have been suggested, such as "reason for default" or "reason for delinquency," but these are equally unsatisfactory; since repossession is a last resort after all other methods of adjustment have failed, delinquency and default have already occurred, and, although they are usually attributable to the same reason as repossession, they may sometimes be caused by slightly different circumstances. A second major source of difficulty is that of setting up mutually exclusive categories of reasons. Most cases of repossession reflect a set of complicated circumstances involving the purchaser, and it is well-nigh impossible to establish a classification which will not allow a given case to fall legitimately in any one of several classes.

On the basis of its experience the source company has classified five broad categories of reasons for repossession, each of which is broken down into two or more subdivisions. The first category includes cases of "financial risk" or "weak initial credit." It is intended to cover purchasers who overestimated their ability to pay, and also those who found automobile upkeep too high to continue. The second category covers "moral risk" or "intentional breach of faith," and includes a variety of sins on the part of the purchaser: confiscation (car recovered from federal, state or municipal authorities following seizure); conversion (purchaser disposes of car, necessitating repossession from third party); collision (purchaser unwilling to repair car and continue his obligation); abandonment; insurance claims (resulting in repossession because purchaser will not continue with his account); change in wants of the consumer; misuse of car (value of car not worth amount of remaining payments because of bad treatment accorded it by purchaser); intention to convert

(including all cases not elsewhere provided for, where car has been secreted intentionally or otherwise).

The third group includes cases of "reverses": financial reverses (loss of job, reduction of salary, business difficulties and the like); personal reverses (illness, injury or death to purchaser or some member of his family); litigation against purchaser; and major catastrophes, such as flood or hurricane. The fourth category covers dissatisfaction on the part of the purchaser with the mechanical condition of his car, or with the service he receives, and under this heading are also included cases in which the purchaser "claims misrepresentation as to year, model, terms, etc.," and cases of "insufficient equity either at time of purchase or subsequent thereto." The fifth and last group includes cases of fraudulent or fictitious sale, such as is sometimes arranged by dealers for the purpose of raising money.

Table 39 shows for both new and used cars the relative importance of the five main categories of reasons for repossession, and the way in which the repossession ratio is distributed among them. Reverses stand out as by far the foremost reason for repossession, with financial risk second; together these two groups account for 82 percent of both new- and used-car repossessions. The financial risk group, it will be remembered, includes purchasers who overestimated their ability to pay or found car upkeep too high for their income. Presumably with careful credit selection these cases, which totaled just under a third of both new- and used-car repossessions, could have been detected and their paper refused; the balance, or slightly more than two-thirds of the repossession cases of this one company, were unpredictable and unavoidable. In other words, roughly one out of every hundred new-car instalment deals resulted in repossession that would have been preventable by prior credit selection, while about two out of every hundred new-car deals ended in unpreventable repossession. For used cars, more careful credit

TABLE 39

PERCENTAGE DISTRIBUTION OF REPOSSESSIONS, 1933–37, ON NEW AND USED CARS FINANCED DURING 1933–36, AND DISTRIBUTION OF THEIR REPOSSESSION RATIO, BY REASON FOR REPOSSESSION[a]

Reason for Repossession	*Percentage Distribution of Repossessions*	*Distribution of Repossession Ratio*[b]
	NEW CARS	
Financial Risk	29.3	.8
Moral Risk	16.8	.5
Reverses	52.5	1.4
Dissatisfaction	1.3	[c]
Fraud	.1	[c]
ALL REASONS	100.0	2.7
	USED CARS	
Financial Risk	32.7	3.8
Moral Risk	12.7	1.5
Reverses	49.8	5.7
Dissatisfaction	4.7	.6
Fraud	.1	[c]
ALL REASONS	100.0	11.6

[a] Based on data supplied by a large sales finance company, covering 57,739 new-car and 354,052 used-car repossessions.

[b] Ratios for individual reasons are computed by multiplying the ratio for all reasons (total number of repossessions per hundred cars financed) by the percentages in the preceding column.

[c] Less than 0.05 percent.

selection might have reduced the average number of deals ending in repossession from around twelve out of every hundred to approximately eight.

Table 40 gives, for both new and used cars, and for each category of reasons, the cumulative percentage of repossessions by number of instalments paid. This table shows that before ten payments have been made there is little difference in the relative importance of the various reasons for repossession; in other words, more than nine out of ten new-car and practically all used-car repossessions come before the

TABLE 40

CUMULATIVE DISTRIBUTION OF REPOSSESSIONS, 1933–37, OCCURRING FOR VARIOUS REASONS ON NEW AND USED CARS FINANCED DURING 1933–36, BY NUMBER OF INSTALMENTS PAID[a]

Reason for Repossession	*Cumulative Distribution by Number of Instalments Paid*											*% Distribution by Reason for Repossession*
	0	1	2	3	4	5	6	7	8	9	10 & Over	
						NEW CARS						
Financial risk	15.5	28.4	41.5	53.5	64.3	73.2	80.0	85.4	89.5	97.1	100.0	29.3
Moral risk	13.8	26.0	38.3	50.5	60.9	69.8	77.2	83.3	87.8	95.4	100.0	16.8
Reverses	12.1	23.7	36.2	48.0	58.7	68.4	76.2	82.4	86.9	96.4	100.0	52.5
Dissatisfaction[b]	20.0	37.0	49.0	63.0	72.0	78.0	82.0	86.0	90.0	97.0	100.0	1.3
Fraud[c]	..	..	..	..	..	..	..	..	..	..	..	.1
ALL REASONS	13.5	25.6	38.3	50.2	60.9	70.1	77.5	83.3	87.7	95.4	100.0	100.0
						USED CARS						
Financial risk	25.4	44.6	61.3	74.1	83.3	89.5	93.7	96.3	97.9	99.1	100.0	32.7
Moral risk	22.5	40.1	56.1	68.8	79.1	86.4	91.4	94.7	97.0	98.6	100.0	12.7
Reverses	20.5	38.9	55.4	68.8	79.1	86.7	91.8	95.1	97.2	98.7	100.0	49.8
Dissatisfaction	37.4	58.9	74.1	84.0	90.2	94.1	96.5	98.0	98.9	99.5	100.0	4.7
Fraud[c]	..	..	..	..	..	..	..	..	..	..	..	.1
ALL REASONS	23.0	41.6	58.0	71.3	81.0	88.0	92.7	95.7	97.6	98.9	100.0	100.0

[a] Based on data supplied by a large sales finance company, covering 57,739 new-car and 354,052 used-car repossessions.
[b] Because of the small number of new cars repossessed for this reason the figures showing the distribution by number of instalments paid are given only to the nearest percent.
[c] Cumulative distribution not computed because of the small number of cases.

tenth payment, regardless of reason. The only significant variation as between reasons appears in the first few months of the instalment period. Before the second payment a larger percentage of dissatisfaction repossessions occur than of those for any other reason. This suggests that instalment purchasers are more likely to become dissatisfied shortly after purchase than later, and that comparatively few purchasers, no matter how dissatisfied, are willing to permit repossession after they have made a number of payments, unless they are for some other reason unable to continue paying.

7

Repossession Experience: Electric Appliances

IN THE financing of electric appliances, the second major field of sales finance company operations, the significance of contract terms and cash selling price as factors affecting the likelihood of repossession is on the whole consistent with what has been indicated for automobile financing. For appliances, however, it is possible to consider the relevance of certain additional factors on which no data were available for automobiles, and to consider more extensively the interrelationship of various factors.

In the following discussion, as in the preceding chapter, repossession experience is measured by the number of repossessions per hundred contracts financed. A ratio indicating dollar losses is even less significant in appliance financing than it is in automobile financing, for the former is usually conducted on a recourse basis, and thus it is in most cases the dealer who assumes any loss that may be incurred.

CHARACTERISTICS OF THE DATA

The most extensive data available on appliance repossessions are those of the Electric Home and Farm Authority, which, though a public agency, operates after much the same fashion as a private finance company. The following analysis is based primarily on these EHFA records.[1] In appliance

[1] For a more detailed tabulation of this material see National Bureau of Economic Research (Financial Research Program), *Government Agencies of Consumer Instalment Credit,* by Joseph D. Coppock (ms. 1940) Appendix B.

financing, as in automobile financing, no single company can be considered typical in every detail, but this consideration does not invalidate the present body of data, for we are here interested in general relationships rather than absolute figures. On the significance of two important items, down payment and length of contract, supplementary information is available on the experience of a large private sales finance company in regard to its "new retail diversified financing." The latter data do not cover exactly the same types of commodities as those financed by EHFA, for they are not limited to electric appliances, and some light producer goods are included. The great majority of this private company's contracts, however, are for refrigerators sold to householders, and refrigerator contracts constituted well over half of all contracts bought by EHFA during the main period under discussion.

Table 41, which presents comparative figures for refrigerator contracts financed during the calendar year 1937 by EHFA and the private company, gives some indication of the extent to which EHFA contracts are typical. On the principle that relatively easy terms would result in satisfactory performance on contracts, EHFA has from the beginning encouraged smaller down payments and smaller monthly payments spread over longer periods of time than private finance companies typically accept. Also, it has from the beginning made a comparatively low finance charge—5 percent a year on the original unpaid balance, or an annual interest charge of 9.23 percent. On the private company's contracts that are tabulated here the rate of finance charge was 6 percent on the initial unpaid balance—equivalent to an annual interest charge of 11.08 percent.

EHFA has no complete record of repossessions from its beginning in 1934, but a fairly full record has been kept since January 1937. Obviously the longer the time that contracts have been outstanding when repossession ratios are

TABLE 41

CHARACTERISTICS OF REFRIGERATOR CONTRACTS FINANCED BY A PUBLIC AND BY A PRIVATE SALES FINANCE COMPANY, 1937[a]

Item	Public Company		Private Company	
	Average Amount	% of Cash Selling Price	Average Amount	% of Cash Selling Price
Cash selling price	$178.00	100	$192.00	100
Down payment	25.00	14	28.00	15
Original unpaid balance	153.00	86	164.00	85
Finance charge	20.00	11	25.00	13
Amount of note	173.00[b]	97[b]	189.00	98
Monthly payment	5.40	3	6.50	3
Average length of contract	32 months[c]		29 months[c]	

[a] Based on data supplied by Electric Home and Farm Authority and by a large private sales finance company, covering, respectively, 14,632 and 101,111 refrigerator contracts financed during calendar year 1937.
[b] Calculated on basis of contracts financed from January through June 1938.
[c] Number of contracts rather than dollar value of contracts was used in weighting various length-of-contract classes.

calculated, the greater the confidence that can be placed in those ratios. Therefore the present analysis is based primarily on the 16,007 contracts financed from January through June 1937. Of these contracts 1,049, or 6.6 percent, had repossessions reported on them by June 30, 1938, when the contracts had been outstanding for an average of 15 months. It is true that not all of the ultimate total of repossessions on these contracts had occurred by the end of June 1938—some of the contracts were for as long as five years and will not be liquidated until 1942—but we have estimated[2] that the 1,049 re-

[2] On the basis of all repossessions reported by October 31, 1938, on contracts purchased during the 18 months from January 1937 through June 1938. The method used was the arbitrary one of extrapolating a curve passed through the given proportions of repossessions occurring at the end of each monthly interval after purchase. At 15 months—which, for the smaller sample of contracts used in our analysis, was the average length of time after purchase—the proportion of final repossessions was found to be 80 percent. The curve flattened out at 30 months, suggesting that 100 percent of repossessions are

possessions constitute approximately 80 percent of the future final total. In no cases do the ratios based on these repossessions show notably different tendencies from those based on the less adequate data of later samples.

Information on purchasers' income—an item which was not covered in the sample for January-June 1937—has been derived from the contracts financed during January-March 1938. Repossessions on this body of contracts were tabulated as of September 30, 1938, when the contracts had been outstanding for an average of 7½ months; at this time, according to our estimates,[3] less than half the final total of repossessions had occurred.

REPOSSESSION EXPERIENCE ACCORDING TO NUMBER OF INSTALMENTS PAID

Appliance repossessions, like those for automobiles, tend to concentrate in the early months of the span. Table 42 shows that over a third of the total number of repossessions estimated to occur on EHFA contracts purchased during January-June 1937 took place before three payments were made; practically half occurred before five payments, and more than three-fourths came within ten payments. This latter proportion may be still higher after all the repossessions on these contracts are tabulated.

In repossession cases there is always, of course, a period of

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probable within a 30-month span. The cumulative percentage of repossessions, by number of months after purchase, was found by this method to be as follows:

2	months	— 9%	9	months	—55%	16	months	— 82%
3	"	—17	10	"	—59	17	"	— 84
4	"	—24	11	"	—64	18	"	— 86
5	"	—32	12	"	—68	19	"	— 88
6	"	—38	13	"	—72	20	"	— 90
7	"	—45	14	"	—76	25	"	— 96
8	"	—50	15	"	—80	30	"	—100

[3] See footnote 2, above.

TABLE 42

PERCENTAGE DISTRIBUTION AND CUMULATIVE PERCENTAGE OF REPOSSESSIONS, JANUARY 1937–JUNE 1938, ON APPLIANCES FINANCED DURING JANUARY–JUNE 1937, BY NUMBER OF INSTALMENTS PAID[a]

Number of Instalments Paid	*Percentage Distribution of Repossessions*	*Cumulative Percentage of Repossessions*
0	18	18
1	8	26
2	8	34
3	7	41
4	7	48
5	7	55
6	5	60
7	4	64
8	5	69
9	4	73
10	3	76
11	2	78
12[b]	2	80
Over 12	20	100

[a] Based on data supplied by Electric Home and Farm Authority, covering 1,049 repossessions reported on 16,007 contracts; it is assumed that these repossessions constitute 80 percent of the final future total.

[b] Of the 1,049 repossessions reported, 1,027 had had 12 or fewer instalments paid; for most of the remaining 22 there was no information.

delinquency in addition to the number of months required for any given number of instalments, and EHFA has found that this delinquency period averages three to four months. It will be remembered that June 30, 1938, when 80 percent of the total repossessions on January-June 1937 contracts are estimated to have occurred, represented an average of 15 months after the contracts were financed; on this date, however, no more than 12 instalments had been paid on the repossessed appliances.[4] This relatively long delinquency pe-

[4] Of the 1,049 repossessions that had occurred by this date, 1,027 had had 12 or fewer instalments paid; for most of the others there was no information.

TABLE 43

NUMBER OF INSTALMENTS PAID BEFORE REPOSSESSION, JANUARY 1937–JUNE 1938, ON APPLIANCES FINANCED DURING JANUARY–JUNE 1937, BY LENGTH OF CONTRACT[a]

Length of Contract[b] (in months)	*Number of Instalments Paid Before Repossession*		*Percentage Distribution of Repossessions*
	Average Number	% of Contract Length	
6	.3	5.6	.3
12	2.3	18.8	5.3
18	3.4	19.1	5.9
24	3.6	15.1	22.7
30	5.7	19.1	2.2
36	3.7	10.3	56.0
48	4.9	10.2	3.7
60	3.9	6.5	3.9
ALL APPLIANCES	4.1	12.2	100.0

[a] Based on data supplied by Electric Home and Farm Authority, covering 1,049 repossessions reported on 16,007 contracts.
[b] Equivalent to total number of payments due.

riod is due partly to a rather generous policy with reference to delinquency, but it is also partly the result of the dealers' reluctance to repossess appliances. Dealers are reluctant because the costs of recovery, repair and resale are heavy, and deficiency judgments against purchasers for the unpaid balances are usually unsatisfactory.

In Table 43 the average number of instalments paid before repossession is shown in relation to contract length, thus indicating the extent to which purchasers had fulfilled their obligations by the time repossession occurred. On the average about 4 payments were made before repossession—approximately 12 percent of the total number due. On repossession cases having contract lengths of 30 months or less,[5]

[5] With the exception of the small proportion having 6-month contracts.

the proportion of payments made to payments contracted for was fairly uniform, but considerably higher than it was on those with contracts longer than 30 months. Data are less complete, however, on the cases having contracts longer than 30 months,[6] and it has not been feasible to make any correction of them.

PURCHASER'S INCOME AS A FACTOR IN REPOSSESSION

In discussing automobile repossessions it was mentioned that the purchaser's income is an important factor which should be taken into account in any study of repossession experience. The absence of information precluded any consideration of this factor in connection with the retail financing of automobiles, but EHFA data, while not so complete on this as on other aspects of repossession experience, enable us to consider it in regard to appliance repossessions. The significance of income lies not only in its absolute amount but also in the proportion of monthly income required for monthly payments, since the latter are necessarily a fixed charge for the period of the instalment contract.

Table 44, based on a special tabulation of contracts financed in the first quarter of 1938, shows a pronounced tendency for the repossession ratio to decline as purchaser's monthly income increases. The ratio is less than average for purchasers receiving over $125 a month, and decidedly worse than average for those receiving under that amount. The better-than-average group accounted for 57 percent of the contracts, and the worse-than-average accounted for 38 per-

[6] Since contracts written for 30 months or under were more nearly paid off by June 30, 1938, it is plausible that repossessions subsequent to this date would be relatively more numerous on contracts running longer than 30 months, thus tending to raise, for this group of cases, both the average number of payments made and the relationship of this number to the total number of payments contracted for.

TABLE 44

REPOSSESSION EXPERIENCE, JANUARY–SEPTEMBER 1938, ON APPLIANCES FINANCED DURING JANUARY–MARCH 1938, BY PURCHASER'S MONTHLY INCOME[a]

Monthly Income[b]	*Repos-session Ratio*[c]	*Index of Repossession Experience*[d]	*% Distribution of All Contracts Financed*
Under $50	5.0	+ 35	1.0
50– 75	8.4	+127	4.0
75–100	6.7	+ 81	10.3
100–125	4.9	+ 32	22.5
125–150	2.6	– 30	16.3
150–200	2.8	– 24	22.4
200 & over	1.7	– 54	18.5
No information	2.6	– 30	5.0
ALL APPLIANCES	3.7		100.0

[a] Based on data supplied by Electric Home and Farm Authority, covering 10 percent of a sample of 7,680 contracts.
[b] Each level is inclusive of the lower figure and exclusive of the higher.
[c] Number of repossessions per hundred contracts financed.
[d] Obtained by calculating each repossession ratio as a percent of average repossession ratio and subtracting 100; the result shows each level's deviation from the average of all levels, the plus indicating worse than average and the minus indicating better than average.

cent. This experience conforms closely with that encountered in another field of consumer instalment credit—personal small loans. The pattern of personal finance company charge-off experience—which is the cash loan equivalent of repossession experience in sales financing—is strikingly similar, in its general outlines, to the pattern which is indicated in Table 44.[7]

[7] See National Bureau of Economic Research (Financial Research Program), *Personal Finance Companies and Their Credit Practices,* by Ralph A. Young and Associates (1940) p. 97, for the charge-off experience of one large chain of personal finance lenders during 1934-37. In this study the $100-150 income bands were found to have about the average proportion of charge-offs and to include about one-third of the loans; in Table 44 the $100-150 income bands have about the average proportion of repossessions and include 39 percent of the contracts covered by the sample.

The significance of purchaser's income as an indicator of the likelihood of repossession appears, on the whole, to be irrespective of other factors. Supplementary tabulations of EHFA data indicate that as income increases, repossession ratios tend to decline for all down payments, all contract lengths, all note amounts (with noteworthy regularity) and all types of appliances (though not so conspicuously for radios). The only factor that seems to outweigh that of absolute income is the related one of monthly payment in percent of monthly income. For those contracts—less than a third of the total—on which monthly payment represented less than 2½ or more than 7½ percent of monthly income the purchaser's absolute monthly income appeared to be of relatively minor significance.

This latter factor—the proportion of monthly income (as of the time when the contract begins) that is required for monthly payment—is probably the most adequate single measure of the purchaser's financial capacity to meet his obligation. As shown in Table 45, the likelihood of repossession is much greater if monthly payment takes a larger share of monthly income. The repossession ratio is roughly twice as high when the monthly payment is 5 to 10 percent of the monthly income as it is when the payment is less than 5 percent.

It will be noticed, however, that when monthly payment is over 10 percent of income the repossession ratio is somewhat lower. This reversal of the trend is not readily explainable, but careful sifting of contracts by dealers and credit men is the most likely reason that can be adduced for it. The number of cases represented by the group is very small, however—less than 3 percent of the total.

The tendency for repossession ratios to increase as the monthly payment percentage rises is shown by additional EHFA data to hold mainly for the groups receiving incomes

TABLE 45

REPOSSESSION EXPERIENCE, JANUARY–SEPTEMBER 1938, ON APPLIANCES FINANCED DURING JANUARY–MARCH 1938, BY MONTHLY PAYMENT AS PERCENT OF MONTHLY INCOME[a]

Monthly Payment as % of Monthly Income[b]	*Repossession Ratio*[c]	*Index of Repossession Experience*[d]	*% Distribution of All Contracts Financed*
Under 2½	2.4	−35	19.5
2½–5	3.3	−11	47.1
5–7½	5.3	+43	21.0
7½–10	6.5	+76	4.8
10–22½	4.0	+ 8	2.6
No information	2.6	−30	5.0
ALL APPLIANCES	3.7		100.0

[a] Based on data supplied by Electric Home and Farm Authority, covering 10 percent of a sample of 7,680 contracts.
[b] Each level is inclusive of the lower figure and exclusive of the higher.
[c] See Table 44, footnote c.
[d] See Table 44, footnote d.

of less than $125; the relationship tends to be reversed for groups receiving monthly incomes of $125 or more. It would be obviously absurd to conclude that the larger proportion of income used by the higher income groups is an influence making for a low repossession ratio, but it does appear plausible that "monthly payment as a percent of monthly income" is a much more important factor among the lower than among the higher income groups. The increase in repossession ratios as higher proportions of monthly income are required for monthly payment remains roughly true, however, for all down payments, all contract lengths (very irregularly for those 12 months and under and for those 36 months and over), all note amounts and all types of appliances (though here again the pattern is somewhat irregular for radios).

CONTRACT TERMS AS FACTORS IN REPOSSESSION

The principal terms stipulated in the contract are those covering down payment, number of payments (length of contract) and finance charges. No data are available on the relation of finance charges to repossession experience, but it is possible to draw certain conclusions regarding the significance of down payment and length of contract.

As the down payment on electric appliances increases, the repossession ratio decreases markedly, according to data shown in Table 46 from both the public and the private company under consideration. Supplementary tabulations of EHFA data indicate that this tendency of repossession ratios to decline as down payment increases is irrespective

TABLE 46

Repossession Experience, January 1937–June 1938, and 1936–37, on Appliances Financed by a Public and by a Private Sales Finance Company, January–June 1937, and 1936, by Down Payment[a]

Down Payment[b] (in % of cash selling price)	*Repossession Ratio*[c] Pub. Co.	*Repossession Ratio*[c] Priv. Co.	*Index of Repossession Experience*[d] Pub. Co.	*Index of Repossession Experience*[d] Priv. Co.	*% Distribution of All Contracts Financed* Pub. Co.	*% Distribution of All Contracts Financed* Priv. Co.
Under 10	9.0	7.6	+36	+46	52.7	27.2
10–20	4.5	5.4	−32	+ 4	31.0	48.7
20–30	2.8		−58		9.9	
30–40	2.0	2.2	−70	−58	4.0	24.1
40 & over	1.3		−80		2.4	
All Appliances	6.6	5.2			100.0	100.0

[a] Based on data supplied by Electric Home and Farm Authority, covering 16,007 contracts, and on data supplied by a large private sales finance company, covering 106,170 contracts, mostly for refrigerators.
[b] Each level is inclusive of the lower figure and exclusive of the higher.
[c] See Table 44, footnote c.
[d] See Table 44, footnote d.

of contract length, amount of note or type of appliance financed, and irrespective of purchaser's income and the proportion of it required for monthly payment.

The data in Table 46 indicate that the repossession ratio is cut approximately in half if the down payment is increased from less than 10 percent to 10-20 percent of cash selling price, and is again cut in half if down payment is 20 percent or more. It is not to be inferred, however, that these would be the results if dealers required higher down payment percentages from all purchasers, because "other things" might not remain equal. Specifically, if the purchaser groups who have not found it feasible to make larger down payments were requested to do so, they might be eliminated from the market or they might default on their contracts in as high a proportion as they would under easier terms, perhaps even higher. For those purchasers who may eventually default because, though financially able, they are unwilling to pay, the requirement of a larger down payment percentage, with the view to establishing a substantial equity in the appliance, would appear to be an effective method. But it is difficult, of course, to single out these latter purchasers.

As shown in Table 47, the repossession ratio increases as the length of contract increases until the contract reaches 36 months. This conclusion, based on data from the two agencies already mentioned, is supported by the experience of a second private company.[8]

For contracts running longer than 36 months there are no conclusive figures. Of the three agencies whose data have

[8] For the repossession experience of this company the only available data are with reference to length of contract, for the years 1936-38. According to a memorandum sent to the National Bureau of Economic Research (Financial Research Program) on January 19, 1939, "Repossessions on contracts running from 13 to 24 months inclusive are about 20 percent greater than on contracts running 12 months or less. Repossessions on contracts running from 25 to 36 months inclusive are about 65 percent greater than on contracts running 12 months or less; and about 35 percent greater than on contracts running from 13-24 months."

TABLE 47

REPOSSESSION EXPERIENCE, JANUARY 1937–JUNE 1938, AND 1936–37, ON APPLIANCES FINANCED BY A PUBLIC AND BY A PRIVATE SALES FINANCE COMPANY, JANUARY–JUNE 1937, AND 1936, BY LENGTH OF CONTRACT[a]

Length of Contract[b] (in months)	*Repossession Ratio*[c]		*Index of Repossession Experience*[d]		*% Distribution of All Contracts Financed*	
	Pub. Co.	Priv. Co.	Pub. Co.	Priv. Co.	Pub. Co.	Priv. Co.
1–6	3.2	1.5	−52	−71	.6	9.4
7–12	4.4		−53		7.9	
13–18	6.5	3.0	− 2	−42	6.0	6.1
19–24	6.5	5.0	− 2	− 4	22.9	29.1
25–36	7.4	6.2	+12	+19	51.3	55.4
37–48	5.2	..	−21	..	4.7	..
49–60	3.9	..	−41	..	6.6	..
ALL APPLIANCES	6.6	5.2			100.0	100.0

[a] Based on data supplied by Electric Home and Farm Authority, covering 16,007 contracts, and on data supplied by a large private sales finance company, covering 106,170 contracts, mostly for refrigerators.

[b] In each level over 90 percent of the contracts were for exactly the span of the second figure. Of the private company's contracts less than 0.1 percent were for more than 36 months.

[c] See Table 44, footnote c.

[d] See Table 44, footnote d.

been used here, only EHFA granted such terms. But only about 11 percent of its contracts were for more than 36 months, and supplementary tabulations show that such terms are not granted at all on refrigerators and washing machines, which together account for about two-thirds of all contracts financed by EHFA. Also, on these longer contracts (mainly for ranges and combination purchases) figures concerning repossession experience are necessarily incomplete since none extended in the period covered by this study had reached maturity.

These data indicate, however, a decrease in the repossession ratio for contracts running 37-48 months, and a still further decline for those running 49-60 months. And the tendency of repossession ratios to increase as contracts become longer, but to drop again for contracts running more than 36 months, appears to be independent of amount of note, for the same trend is roughly discernible in each amount-of-note level. Still more disruptive of conventional assumptions is the indication that declining repossession ratios for contracts running longer than 36 months are general, regardless of down payment: this rough trend is observable in each down payment classification.[9]

It will be remembered that also in used-car financing, repossession ratios declined on longer contracts. Careful selection by credit men and the granting of longer contracts mainly on higher-priced, lower-risk cars were suggested as possible explanations. In appliance financing too the dealers and credit men probably select with special care the customers who receive longer contracts, but in the absence of adequate evidence this factor should not be considered a complete explanation. Nor can the price of the commodities that are typically financed on longer contracts explain the

[9] On deals carrying less than 10 percent down payment, data are available also for the private company, for the various contract lengths, and show a trend different from that of EHFA figures. The two agencies' indices of repossession experience, based on the average for all contract lengths, are as follows:

Contract Length	*Pub. Co.*	*Priv. Co.*
Under 13	− 8	− 41
13-18	+ 17	− 38
19-24	+ 7	− 33
Over 24	− 3	+ 8

The data from which these figures were computed covered, for EHFA, 762 repossessions occurring by June 30, 1938, on 8,436 contracts financed during the first six months of 1937; and, for the private company, 1,864 repossessions occurring by December 31, 1937, on 36,119 contracts financed during 1937. EHFA contracts had been outstanding an average of 15 months, the private company's contracts an average of only 6 months. It is impossible to say whether these contradictions will remain when both bodies of contracts are finally liquidated.

present finding: on most range contracts the note was for $100-300, a level that had about an average repossession record; and only about a quarter of the combination contracts were for a note-amount level that showed notably better-than-average performance ($300-400). It would seem plausible that on these longer contracts monthly payments would take a smaller proportion of monthly income, but payments taking less than 5 percent of income—the proportion that seems to make for the best repossession record—were less prevalent among 48-month contracts than among those of any other length; such payments characterized more than nine-tenths, however, of the 60-month contracts.

The most adequate explanation that seems possible from statistical analysis is purchaser income. It is true that within each monthly income level, and also within each level of monthly payment in percent of income, the repossession ratios show no discernible trend as contract length increases. But 70 percent of the holders of contracts running 48 months, and 85 percent of those whose contracts ran 60 months, had monthly incomes of more than $125, in other words, belonged to the income group that consistently showed better-than-average performance on contract obligations. This finding is confirmed by a tabulation which indicates that two-thirds of those whose contracts were for ranges and combination purchases fell within this income level.

In general, however, it would seem that the significance of contract length in indicating the likelihood of repossession is particularly subject to misinterpretation and exaggeration. Very short contracts seem to be, indeed, a good risk, but in EHFA experience with appliance financing, contracts of one to three years have a fairly average repossession record and those of three to five years show even a better-than-average performance. Careful credit selection, and the fact that such contracts go mainly to income groups above $125

a month, may partially, or even wholly, explain this finding, but in any case the tendency should be given some weight in appraising the influence of lending policy on collection experience.

AMOUNT OF NOTE AND MONTHLY PAYMENT AS FACTORS IN REPOSSESSION

As the amount of note (original unpaid balance plus time-payment charge) increases, the repossession ratio decreases slightly and irregularly, as shown in Table 48. The same generalization could be made for the repossession ratio in relation to cash selling price, because in EHFA contracts the latter is approximately the same as the amount of note. It is quite possible, however, that later repossessions on the longer contracts (a majority of the contracts for $300 and over were for 48 months or longer) will increase their re-

TABLE 48

REPOSSESSION EXPERIENCE, JANUARY 1937–JUNE 1938, ON APPLIANCES FINANCED DURING JANUARY–JUNE 1937, BY AMOUNT OF NOTE[a]

Amount of Note[b]	*Repossession Ratio*[c]	*Index of Repossession Experience*[d]	*% Distribution of All Contracts Financed*
$40– 100	7.0	+ 6	25.0
100– 200	6.4	− 3	50.2
200– 300	6.8	+ 3	19.4
300– 400	4.4	−33	3.8
400–1000	5.9	−11	1.6
ALL APPLIANCES	6.6		100.0

[a] Based on data supplied by Electric Home and Farm Authority, covering 16,007 contracts.

[b] Each level is inclusive of the lower figure and exclusive of the higher.

[c] See Table 44, footnote c.

[d] See Table 44, footnote d.

possession ratios, and in this case the ratios of all amount-of-note levels would be very close to average.

Here again other factors, especially length of contract, should be considered simultaneously. Supplementary tabulations indicate that for contracts of 24 months or less repossession experience improves conspicuously as notes become larger. For contracts of 36 months or more no clear pattern is discernible. But the general tendency of the repossession ratios to remain fairly steady, or decrease, with increasing amount of note is true, on the whole, irrespective of down payment percentage, monthly payment percentage, customer's income or type of appliance. Thus it seems probable that amount of note is not among the more significant factors that indicate the likelihood of repossession.

Monthly payment is amount of note divided by length of contract, and represents in one figure the composite influence of these two factors. It is of particular interest to see that the repossession ratio declines very clearly as the absolute

TABLE 49

REPOSSESSION EXPERIENCE, JANUARY 1937–JUNE 1938, ON APPLIANCES FINANCED DURING JANUARY–JUNE 1937, BY SIZE OF MONTHLY PAYMENT[a]

Size of Monthly Payment[b]	*Repossession Ratio*[c]	*Index of Repossession Experience*[d]	*% Distribution of All Contracts Financed*
$1.50– 4	7.1	+ 8	35.7
4– 8	6.7	+ 2	55.9
8–12	3.2	−52	6.4
12–20	3.4	−48	2.0
ALL APPLIANCES	6.6.		100.0

[a] Based on data supplied by Electric Home and Farm Authority, covering 16,007 contracts.

[b] Each level is inclusive of the lower figure and exclusive of the higher.

[c] See Table 44, footnote c.

[d] See Table 44, footnote d.

size of monthly payment increases. This is evident from Table 49, which shows that the repossession ratio is twice as high when monthly payments are less than $8 as it is when they are more than this amount. Purchasers who commit themselves to larger monthly payments seem better able to judge their financial capacity and to maintain the subsequent payments, but another factor is that equity cumulates more quickly with larger instalment payments, thus heightening the customer's reluctance to lose possession of his purchase.

TYPE OF APPLIANCE AS A FACTOR IN REPOSSESSION

During the period under consideration over 80 percent of the contracts purchased by EHFA were for refrigerators, electric ranges and washing machines. Other types of electric appliances and combinations of two or more appliances accounted for the remainder. As shown in Table 50, washing machines had the highest proportion of repossessions (10 percent of all washing machines financed) and ranges had the lowest (3 percent); the repossession ratio does not show any significant variation for refrigerators, combinations, and "others."

The various appliances maintain roughly their average ranking, in regard to repossession ratio, regardless of note amount (although for notes of less than $200, combination purchases—of which one-fifth were in this class—showed the highest ratios), or down payment percentage, or contract length (except for the shortest and the longest contracts), or monthly payment percentage (although when payments took less than 2½ percent or from 5 to 7½ percent of monthly income, the miscellaneous purchases—of which over two-thirds were in these classes—had the lowest ratios). When payments took 2½ to 5 percent of monthly income, radios,

TABLE 50

REPOSSESSION EXPERIENCE, JANUARY 1937–JUNE 1938, ON APPLIANCES FINANCED DURING JANUARY–JUNE 1937, BY TYPE OF APPLIANCE[a]

Type of Appliance	*Repossession Ratio*[b]	*Index of Repossession Experience*[c]	*% Distribution of All Contracts Financed*
Refrigerators	6.5	− 2	53.4
Ranges	3.2	−52	14.8
Washing machines	9.9	+50	12.7
Combinations[d]	7.7	+17	11.7
Others[e]	6.6	0	7.4
ALL APPLIANCES	6.6		100.0

[a] Based on data supplied by Electric Home and Farm Authority, covering 16,007 contracts.
[b] See Table 44, footnote c.
[c] See Table 44, footnote d.
[d] Contracts for two or more appliances.
[e] Includes water heaters, water pumps, milk coolers, cream separators, clothes ironers, farm motors, vacuum cleaners, dishwashers, waste disposal units, feed grinders, milking machines, radios and portable space heaters; on each of these the number of repossessions was too small to allow of significant conclusions if tabulated separately.

on which information is available only for 1938,[10] showed the highest repossession ratio of any commodity (41 percent of radios were in this class), but when payments took 5-10 percent of income (45 percent of radios were in these classes) they showed notably lower ratios than most other appliances.

The most plausible reason why the ratio for washing machines is more than three times that of ranges seems to be that time-purchasers of electric ranges tend to be persons

[10] Before the fiscal year 1937-38 radios constituted less than 1 percent of all contracts financed by EHFA, but in that year they amounted to 8 percent of the total. The figures for income, tabulated as of September 30, 1938, on January-March 1938 contracts, include separate information on radios. According to these data the repossession ratios of the various appliances were: radios 4.8; washing machines 4.3; combinations 4.0; refrigerators 3.5; ranges 2.7; others 2.1—an average of 3.7.

with considerably larger incomes than the general run of washing-machine instalment purchasers. Income data, available for 1938 but not for 1937, show average monthly income to be $133 for the latter, but $158 for electric-range purchasers. Within any particular purchaser-income level the average ranking of the different appliances' repossession ratios varied considerably, with no discernible pattern. Radios had higher-than-average repossession ratios in all income levels except those between $125 and $200, which contained 42 percent of the radio contracts.

These tendencies suggest that differences in performance on instalment contracts covering different types of appliances are more attributable to income than to the type of appliance. It does not appear possible to argue that some appliances are necessities and others luxuries; all are of what might be called a semi-luxury character.

IMMEDIATE REASONS FOR REPOSSESSION

For electric appliances, as for automobiles, the available categories of immediate reasons for repossession are too indefinite and overlapping to afford much significant information. In Table 51, however, the reported reasons for EHFA repossessions have been arranged roughly in accordance with the categories used in the chapter on automobile repossession, in order to suggest the relative importance of the various reasons and the way in which the repossession ratio is distributed among them. The fact that nearly half of the cases are classified under "no information" and "unable to pay" indicates the difficulty of determining precise reasons for default. The "unable to pay" classification covers a great variety of possible difficulties—and probably includes many cases that should be classed under "reverses"—but of all these causes of repossession it is the one most capable of prediction. If those who eventually proved "unable to pay"

TABLE 51

PERCENTAGE DISTRIBUTION OF REPOSSESSIONS, JANUARY 1937–JUNE 1938, ON APPLIANCES FINANCED DURING JANUARY–JUNE 1937, AND DISTRIBUTION OF THEIR REPOSSESSION RATIO, BY REASON FOR REPOSSESSION[a]

Reason for Repossession	*Percentage Distribution of Repossessions*	*Distribution of Repossession Ratio*[b]
Financial Risk	*22.6*	1.5
Unable to pay	22.6	
Moral Risk	*31.3*	2.1
Moved off electric line	12.4	
Irresponsible	10.7	
Able but unwilling	8.2	
Reverses	*20.7*	1.3
Unemployment	15.1	
Illness in family	4.5	
Marital difficulty	.5	
Dissatisfaction and misunderstanding	*5.6*	.4
No information	*20.4*	1.3
ALL APPLIANCES	100.0	6.6

[a] Based on data supplied by Electric Home and Farm Authority, covering 1,049 repossessions.

[b] Ratios for individual reasons are computed by multiplying the ratio for all reasons (total number of repossessions per hundred contracts financed) by the percentages in the preceding column.

could have been detected in advance, just over one-fourth of the classifiable repossession cases might have been avoided.

Classifications of repossession experience by various presumably relevant factors, such as those presented here, are admittedly crude but they do afford a useful guide in considering credit policy. The foregoing analyses suggest that down payment percentage, purchaser's income and the proportion of monthly income required for monthly payment

may be regarded as significant indicators of the likelihood of repossession.

But this is not to deny that it may still pay both the dealer and the finance company to accept dubious paper. If finance charges, dealer reserves, merchandise mark-ups and resale prices on repossessed merchandise are high enough, dubious deals may still be profitable. Moreover, the automatic rejection of any group of contracts, for the reason that they fall within a classification considered doubtful, is likely to mean the rejection also of contracts that would have been successful. Statistical analysis, if sufficiently extensive and sufficiently refined, can do much to narrow these limits of uncertainty, but even the most complete analysis must be supplemented, and perhaps modified, by careful judgment concerning the important factors that are incapable of analysis. And always the fact remains that some proportion of unsuccessful contracts—a higher or lower proportion, depending on operating policies and volume of business—is normal and inescapable in the large-scale extension of consumer credit.

8

Finance Charges

In an instalment transaction the purchaser thinks of the finance charge as the total differential between what he contracts to pay and what he would have paid if he had bought on a cash basis; in other words, he subtracts his original unpaid balance (cash selling price minus down payment) from the amount of his note and regards the remainder as the company's charge for financing his purchase. From the standpoint of the finance company, however, this amount represents several quite different items: the financing service proper; insurance; and provision for dealer loss reserve or other dealer participation.

In regard to these items practice varies between automobile and diversified financing. Within automobile financing it varies from company to company, and even more from one type of company to another; it varies also in the business of a single company—between new-car and used-car financing, between cars of different prices and contracts of different lengths, perhaps even between cars of different manufacturers. In the following discussion of finance charges the more important of these variations will be taken into consideration. As has been the case in other chapters the main problems are evident in the automobile field.

It should be borne in mind that the purchase of a sales finance contract is a discount transaction, and that the customer's note includes the charges for credit and service. This is in contrast to personal finance company lending, where the note covers only the principal, with charges stated as a monthly percent of current unpaid balance.

QUOTATION OF CHARGES IN AUTOMOBILE FINANCING

Sales finance companies customarily quote their charges in rate charts which show, in dollars, the total amount of note and the amount of monthly payment that will be required on any particular unpaid balance and any particular contract length. As a rule these charts are distributed only to dealers, but at least one finance company has widely circulated copies of its rate charts among automobile owners and prospective buyers. The amount of monthly payment required is of course the amount of note divided by the number of months the contract runs. The amount of note is the original unpaid balance plus the combined cost of financing service and insurance protection.

In used-car financing—and until recently also in new-car financing—it has not been customary to stipulate the amount of either of these two costs, though their aggregate amount can easily be computed by subtracting the original unpaid balance from the amount of note. Nor is there any indication as to the percentage that these costs amount to—neither the percent of original unpaid balance nor the percent of average credit outstanding during the period of payment. There are various reasons why finance companies have generally avoided any percentage expression of charges. For one thing, the consumer, they allege, is not interested in a percentage quotation. Another reason sometimes advanced is the complexity of expressing a charge on a declining balance in terms of its simple interest equivalent. A third reason is that since the charges involved in instalment sales financing are necessarily higher than in commercial lending, where the loan is paid in full at maturity, it has been thought that their quotation in percentage terms might lead to unjustified comparisons with interest charges prevailing in the field of business financing. Still another reason has been the

desire to avoid confusion with the cash instalment loan field, for there customer charges—practically always expressed in percentage terms, though not as simple per annum interest—are commonly subject to legal regulation, whereas credit charges in merchandise sales are commonly viewed, and have been interpreted by the courts, as part of the sales price and not subject to laws regulating interest.

Table 52 is a copy of the rate chart which a local company employed in 1938 for used passenger automobiles. In general format this is the same as the charts used by most companies in the business, both for new and for used cars, except that it is customary to show, for each amount of unpaid balance, the corresponding amount of note as well as the corresponding monthly instalment. In a chart such as that reproduced here the amount of note can easily be computed, however, by multiplying the monthly instalment by the number of months. The charges indicated in Table 52 should not be interpreted as representative of customary charges in used-car financing. Some companies quote higher charges than these, some companies lower, even for business conducted in the same territory.

The variation to be found in the used-car rate practices of different companies is indicated in Table 53, which presents a comparison of the combined insurance and finance charges quoted on 12-month used-car contracts in 1938 by five sales finance companies, all charges applicable to the same metropolitan region. These figures are to be interpreted not as representing the finance charge proper but as representing the total price quoted to the consumer, including not only a charge for financing service but also a charge for insurance coverage. Since the cost of insurance is not quoted separately it is not possible to say what proportion of these charges is for insurance and what proportion is for financing service. There may be variation among companies in the amount of insurance coverage provided, as well as in the amounts

TABLE 52

USED PASSENGER CAR RATE CHART OF A LOCAL NON-RECOURSE SALES FINANCE COMPANY, 1938

Unpaid Balance	*Monthly Instalment* 24 Months	18 Months	12 Months	*Unpaid Balance*	*Monthly Instalment* 24 Months	18 Months	12 Months
$ 1	$ .06	$ .09	$ .18	$370	$21.22	$26.23	$37.50
2	.12	.17	.28	380	21.76	26.90	38.45
3	.18	.25	.38	390	22.30	27.56	39.39
4	.23	.32	.48	400	22.84	28.23	40.34
5	.29	.39	.58	410	23.37	28.89	41.28
6	.35	.46	.68	420	23.91	29.54	42.21
7	.40	.54	.78	430	24.44	30.20	43.15
8	.47	.61	.88	440	24.97	30.85	44.08
9	.53	.68	.98	450	25.50	31.50	44.98
100	No collision insur-		11.25	460	26.03	32.15	45.93
110	ance on balance		12.29	470	26.56	32.80	46.85
120	less than $150.00		13.30	480	27.09	33.44	47.76
130			14.30	490	27.61	34.09	48.68
140			15.29	500	28.13	34.73	49.59
150		11.00	16.25	510	28.65	35.36	50.49
160		11.72	17.20	520	29.17	35.99	51.40
170		12.43	18.14	530	29.68	36.63	52.30
180		13.14	19.05	540	30.20	37.26	53.19
190		13.85	19.95	550	30.71	37.89	54.09
200	11.75	14.56	20.84	560	31.22	38.52	54.98
210	12.32	15.26	21.84	570	31.73	39.14	55.86
220	12.89	15.97	22.85	580	32.24	39.77	56.75
230	13.46	16.67	23.85	590	32.75	40.39	57.63
240	14.02	17.36	24.84	600	33.25	40.99	58.50
250	14.59	18.06	25.84	610	33.76	41.62	59.38
260	15.15	18.75	26.83	620	34.26	42.23	60.25
270	15.71	19.44	27.81	630	34.76	42.84	61.11
280	16.27	20.14	28.80	640	35.26	43.45	61.98
290	16.82	20.81	29.78	650	35.75	44.06	62.84
300	17.38	21.50	30.75	660	36.25	44.66	63.69
310	17.93	22.19	31.73	670	36.74	45.27	64.55
320	18.48	22.87	32.70	680	37.23	45.87	65.40
330	19.03	23.54	33.66	690	37.72	46.46	66.24
340	19.58	24.22	34.63	700	38.21	47.06	67.09
350	20.13	24.89	35.59	710	38.70	48.05	67.92
360	20.67	25.56	36.54	720	39.14	48.64	68.76

Cars not more than 2 yrs. old—24 months—1/3 down
Cars not more than 3 yrs. old—18 months—1/3 down
Cars not more than 4 yrs. old—12 months—40% down

Rates include Fire, Theft and Collision (deductible specified below) for the full term of the contract. Balances below $150.00 do not include collision.

$50.00 DEDUCTIBLE—Chevrolet; Dodge; Ford; Graham 6; Nash 6; Oldsmobile 6; Plymouth; Pontiac 6; Studebaker 6; Terraplane; Willys; Lafayette.

$75.00 DEDUCTIBLE—Auburn 6; Buick 40, 50; Chrysler 6; DeSoto; Graham 8; Hudson; Hupmobile 8; Oldsmobile 8; Packard 6, 120; Pontiac 8; Reo; Lincoln-Zephyr.

$100.00 DEDUCTIBLE—Auburn 8; Buick 60, 80, 90; Cadillac; Chrysler 8; Hupmobile 8; LaSalle; Lincoln; Nash 8; Packard; Studebaker 8.

TABLE 53

DOLLAR AMOUNT OF COMBINED INSURANCE AND FINANCE CHARGES QUOTED ON USED CARS FINANCED UNDER 12-MONTH CONTRACTS BY 5 SALES FINANCE COMPANIES, 1938, AND INDEX OF VARIATION[a]

Company	*$100 Original Unpaid Balance*		*$200 Original Unpaid Balance*		*$400 Original Unpaid Balance*		*$600 Original Unpaid Balance*	
	Dollar Charge	Index of Variation	Dollar Charge	Index of Variation	Dollar Charge	Index of Variation	Dollar Charge	Index of Variation
A	$30.08	100	$47.92	100	$57.44	100	$ 73.44	100
B	32.12	107	50.08	105	65.00	113	89.04	121
C	37.40	124	53.80	112	64.40	112	84.60	115
D	30.56	102	49.00	102	58.76	102	74.76	102
E	35.00	116	50.08	105	84.08	146	102.00	139

[a] Taken from rate charts of the five companies, all the charts being applicable to the same metropolitan region. In the index of variation each company's charges are expressed in percent of those of the company quoting the lowest charges.

charged for insurance and for financing service, but in most cases the former difference is considerably less than the latter.

In used-car financing—and for some companies, primarily regional and local, also in new-car financing—it is still the general practice to stipulate in rate charts only the total amount of note (and its division into monthly payments), with no indication of the respective amounts to be allocated to the cost of financing service and of insurance protection. In the fall of 1935, however, General Motors Acceptance Corporation made a reduction in its financing charge for new automobiles, and in what was called the "6 Percent Time Payment Plan" changed its method of stating charges. This plan, confined to the financing of new cars, was quite generally adopted throughout the United States by motor companies and factory-related finance companies, and also, for competitive reasons, by some independent companies.[1] It provided that insurance (paid for by the customer but placed by the financing agency) be reckoned separately from the finance charge, and that the latter be computed on the insurance plus the original unpaid balance, at a rate of ½ percent a month, or 6 percent for twelve months. To illustrate, if the original unpaid balance is $400, payable in twelve equal monthly instalments, and the insurance is $25, the finance company charge is $25.50.

In the beginning the plan was widely advertised, but during 1936 the Federal Trade Commission issued complaints against the motor companies and their finance company affiliates, charging unfair methods in their advertising of the 6 percent plan. The Commission charged that the plan was not truthfully or accurately presented to the public because the advertising tended to convey to prospective purchasers

[1] In its *Report on Motor Vehicle Industry* (1939) p. 967, the Federal Trade Commission stated that "by the spring of 1936, practically the entire industry of financing installment sales of [new] motor vehicles was on the so-called 6-percent basis."

the idea that this was a 6 percent simple interest plan of financing, whereas it actually involved a much higher annual interest rate, since the 6 percent charge was figured on the full amount of the account originally financed, from the date of the transaction to the date the account was closed, regardless of the fact that the account was regularly amortized by monthly payments of equal amounts.

Most of the companies against which the Federal Trade Commission issued complaints signed agreements to "cease and desist"; they agreed not to circulate or to furnish to authorized dealers or distributors any advertising matter in which the expression "6 percent" is used, without giving equal prominence to an explanation making it clear that this rate does not mean 6 percent simple interest.

The General Motors Corporation, however, and its subsidiaries, including General Motors Acceptance Corporation, answered the complaint of the Federal Trade Commission by denying all charges Their answers were filed on December 23, 1936, and they declared that the new plan had been instituted in order to simplify the method of computing rates and to simplify the form of rate quotation, so that purchasers of General Motors cars might be protected from practices and abuses prevalent in the instalment selling methods of certain dealers; and General Motors contended that its advertising adequately explained that the 6 percent was not interest but was only a figure to be used in multiplying the unpaid cash balance in order to compute the amount of the finance charge. The Federal Trade Commission, after a final hearing, announced on December 8, 1939, that the acts and practices complained of are "to the prejudice and injury of the public and of competitors . . . and constitute unfair methods of competition." It ordered the General Motors Corporation and its subsidiaries to cease and desist from using the term 6 percent "or any other words, figures or symbols indicating percentage" in connection with finance

charges when the amount of the charge is in excess of simple interest at that percentage rate, "calculated on the basis of the unpaid balance due as diminished after crediting installments as paid."[2]

It should be emphasized, however, that the issue in this case was the manner of presentation and not the merits of the 6 percent plan itself. In regard to the plan as such the Federal Trade Commission has declared that "if comprehended and applied by the prospective car purchaser [it] would not only enable him to compute the finance charges, the face amount of his installment contract, and the amount of each monthly installment but would enable him to detect any overcharge or 'pack' that the vending dealer might attempt to insert into the finance charges, and thereby to eliminate these packs."[3] Moreover, "the application of this plan constituted a substantial reduction from the rates of finance charge and interest that were in general use just previously."[4]

In new-car financing it is still the practice, especially of the national companies, to base the finance charge on a rate of approximately ½ percent a month, computed on original unpaid balance plus insurance, the latter based on standard territory schedules. Neither in rate charts nor in advertising, however, is the percentage rate mentioned. Insurance on used cars is such a variable item, even within a single territory, that it is considered impracticable to compile a schedule of exact rates to be employed as a basis for a separate statement of insurance charges in used-car financing. The rate charts of at least one company, however (General

[2] Federal Trade Commission, Docket No. 3001, "Findings as to the Facts and Conclusion" and "Order to Cease and Desist" (December 8, 1939). General Motors and General Motors Acceptance Corporation have filed notice of appeal on this order.

[3] Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 972.

[4] *Ibid.*, p. 1076.

Motors Acceptance Corporation), now specify for each transaction not only the dollar amount of monthly payment but also the dollar amount of finance charge. The new-car rate charts show the finance charge alone, but they also contain territory charts showing the exact insurance premium in that area for cars of various types and prices; the used-car rate charts show in dollars the combined cost of financing and insurance.

ACTUAL CHARGES IN AUTOMOBILE FINANCING

So far only quoted charges have been dealt with; but these are not always an accurate gauge of what the consumer is actually charged. For example, the dealer sometimes adds to the amount of the note a "pack" for himself; when this is done the pack is paid by the finance company to the dealer and is then collected from the consumer as part of the face amount of the contract. Differences between the finance charge to the consumer and that indicated by the rate chart may occur also because of errors made by the dealer against himself. Sometimes differences exist between quoted rates and actual rates because of deceptions; the company, for example, may provide the dealer with more than one rate chart, and the dealer may use the higher one in his dealings with the purchaser and the lower one in determining the amount of discount when selling the contract to the finance company.[5] Finally, special circumstances may sometimes lead to higher or to lower charges than those indicated in the rate chart.

The Federal Trade Commission, in connection with its comprehensive investigation of the motor vehicle industry,[6] has compiled data which indicate, for selected contract lengths, the actual finance charges made to purchasers of

[5] *Ibid.*, p. 970.
[6] The study was ordered by a joint resolution of Congress, April 13, 1938.

new and used automobiles during the years 1935-38, and also the constituent items in these charges. From about 60,000 financing transactions, selected directly from the books of finance companies by a method designed to prevent bias, the Commission compiled groups of samples for detailed tabulation. Financing transactions included in the samples originated in the eastern half of the country (North and South Atlantic regions and North and South Central regions), and occurred for the most part in months of greatest retail sales of automobiles during the period 1935-38. The data are classified according to whether the originating finance company was factory-controlled (General Motors Acceptance Corporation), factory-preferred (Commercial Investment Trust Corporation—including its subsidiary, Universal Credit Corporation—and Commercial Credit Company), or independent (a representative sample from each region), so that finance charge practices may be compared as between these types of companies.

The constituent items in the overall charge actually made to the consumer are primarily the finance company's provision for expenses and profit, the retail insurance premium, the dealer's reserve or bonus and sometimes also a pack for the dealer. Insurance is ordinarily required by, and also placed by, the company, but since in most cases it covers the purchaser's as well as the company's interest it is to be regarded more as a supplement to the financing transaction than as an integral part of it. The reserve or bonus is part of the charge as quoted by the finance company. The pack is an amount which is sometimes added by the dealer to the finance company's quoted charge and is then paid to him by the company. The genesis and implications of dealer participations in the charge are discussed more fully in Chapter 11.

Table 54 indicates the relative significance of the constituent items in the combined insurance and finance charges

TABLE 54

CONSTITUENT ITEMS IN COMBINED INSURANCE AND FINANCE CHARGES SHOWN IN SAMPLES OF 12-MONTH AND 18-MONTH NEW-CAR AND USED-CAR TRANSACTIONS FINANCED BY SELECTED GROUPS OF SALES FINANCE COMPANIES, 1936–38, IN PERCENT OF TOTAL COMBINED CHARGES[a]

Item	12-Month Contracts			18-Month Contracts		
	Factory-Controlled Company[b]	Factory-Preferred Companies[c]	Independent Companies	Factory-Controlled Company[b]	Factory-Preferred Companies[c]	Independent Companies
NEW CARS						
Finance company's provision for expenses and profit	42.6	32.1	36.6	49.0	40.4	46.2
Retail insurance premium	46.9	54.2	51.0	40.8	48.3	43.7
Dealer's reserve	10.4	9.5	2.5	10.2	8.6	1.6
Dealer's bonus	..	1.6	8.4	..	1.3	6.9
Dealer's pack[d]	.1	2.6	1.5	[e]	1.4	1.6
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0
Number of transactions	1,456	2,142	2,488	2,019	3,890	4,590
USED CARS						
Finance company's provision for expenses and profit	45.3	48.8	54.4	48.6	55.2	61.3
Retail insurance premium	34.9	29.1	24.7	33.2	30.0	25.4
Dealer's reserve	18.3	15.7	6.4	15.7	9.9	2.7
Dealer's bonus	[e]	.7	12.7	..	.4	8.8
Dealer's pack[d]	1.5	5.7	1.8	2.5	4.5	1.8
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0
Number of transactions	194	395	374	99	485	341

shown in the Federal Trade Commission samples of new-car and used-car transactions for 1936-38. Insurance charges are shown to have taken, on the average, 40 to 50 percent of the total charge on new cars, and 25 to 35 percent of that on used cars. On new-car transactions approximately 10 percent of the average charge went to dealers for reserve or bonus, but on used-car transactions the dealer's share was higher. All packs were "rigorously disallowed" by the factory-controlled company. The small percentages indicated as packs in its new-car transactions may be accounted for by recording fees, notary fees and documentary stamp taxes;[7] on its used-car transactions the percentages appearing as packs were somewhat higher, but the company states that these amounts are due to accounting irregularities and that if any genuine overcharge exists it is credited to the purchaser. The data in this table indicate that on the whole the dealer's pack amounted to a higher proportion of factory-preferred company charges than of other companies' charges. It is possible that the figures on factory-preferred and independent companies somewhat understate the dealer's pack and overstate the dealer's reserve or bonus, for in some cases the pack is wholly or partly concealed in these items.

The remainder of the overall charge, after provision for insurance and dealer participation, represents the proportion which the finance company receives for its expenses and

[7] See Federal Trade Commission report, *op. cit.*, p. 962.

[a] Based on Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) pp. 982, 985, 1032, 1036, 1039, 1043, 1047, 1050.
[b] General Motors Acceptance Corporation.
[c] Commercial Investment Trust Corporation—including its subsidiary, Universal Credit Corporation—and Commercial Credit Company.
[d] A small part of the additions given as packs represented reimbursements to dealers for sums paid out for recording fees, notary fees and the like, but the remainder was pack, as this item is ordinarily defined. Packs were not allowed by the factory-controlled company; this company states that the appearance of such amounts is due to dealers' errors or accounting irregularities, and that if any genuine overcharge exists it is credited to the purchaser.
[e] Less than 0.1 percent.

profit. Actually, however, the finance company usually derives some profit also from the insurance premium, either in the form of commission or in the form of dividends or income from an associated insurance company. The factory-controlled company, though it provides the purchaser with insurance through another subsidiary of the parent corporation, does so at lower than standard rates. On new cars this company's provision for expenses and profit is shown to have averaged a higher proportion of the overall charge than did that of other companies, but it is likely that if insurance income were taken into account the variation among the three types of companies would be less than indicated in these figures. On used cars, where insurance premiums average a much smaller proportion of total charges, the factory-controlled company's provision for expenses and profit amounted to approximately the same proportion as in new-car financing, but for the other companies this item took a much larger part of used-car than of new-car overall charges.

The figures that have been cited pertain only to the content of charges and tell nothing about their comparative size. Since the amount of note varies from one transaction to another it is obviously necessary to express comparative finance charges in percentages rather than in dollar terms, and therefore the question arises as to what basis should be used for computation. The basis used in the sales finance business is the original unpaid balance plus insurance, but rates computed on this basis are comparable, of course, only for contracts of the same length. Moreover, such a rate, while it provides a convenient statement that is readily understandable and readily calculable, does not indicate the actual relative cost of the credit, since it refers to the amount originally owed, without allowance for the fact that this amount is continually reduced during the span of the contract. In the following discussion this rate will be presented, but it will be supplemented by its equivalent in annual per-

centage rate based on a credit balance that is regularly reduced at monthly intervals.[8] It has already been mentioned that among the courts that have had occasion to consider the problem it is the general consensus that sales finance company charges are not to be regarded as interest. But from an economic point of view credit charges, of whatever nature, are properly expressed in terms of the amount of credit extended, in relation to the time the credit is enjoyed.

It should be remembered that although both these rates represent only the rate of finance charge, that charge is computed by the company on the insurance coverage which is required of the purchaser as well as on the original unpaid balance of his purchase. The cost of this insurance varies not only according to the type and price of car and the territory in which it is bought, but also according to the practice of the finance company, and sometimes according to the circumstances of the particular transaction. Most companies, whether they place insurance through subsidiaries, through affiliated companies or through independent companies, provide protection at conference rates. The factory-controlled company, however, through another subsidiary of the parent corporation, provides insurance at rates about one-fourth less than standard.[9] Also, the insurance coverage may vary in different transactions: usually both the purchaser's and the finance company's interests are insured, but sometimes only the company's interest, and in this case the cost of insurance is normally, of course, very much less.

These and other variations in the amount charged for in-

[8] This basis is used also by the Federal Trade Commission in its expression of charges. See Table 55, footnote b, for the principles followed by the Commission in computing the annual percentage rate; the figures cited in the text are those arrived at by the Commission's preferred method rather than those arrived at by the alternative method which it recognizes.

[9] In 1939 this company organized another insurance subsidiary which is available to write business at manual rates where special circumstances exist. It is understood that when this is done there will normally be a reduction in the finance charge percentage.

surance may make significant differences in the dollar amount the purchaser pays, but such differences are not reflected either in the finance charge percentage or in the annual percentage rate which it implies. The inevitable variations in the dollar cost of insurance make it impossible to express this item accurately in percentage terms for purposes of comparison. Cash selling price is the most defensible basis for such an expression, but the resultant figures tell nothing of insurance charges in comparison with finance charges. If insurance is expressed in relation to the original unpaid balance plus insurance—the same base as that used for the finance charge—still another variable, the down payment, is introduced: insurance on a $1000 car, for example, may be 7 percent of original unpaid balance if the customer made only a $300 down payment, or 50 percent if his down payment was $900, as sometimes happens. Both of these bases have been used, however, in the following tables, the total cost of insurance on each sample of transactions being expressed, for purposes of approximate comparison, in percent of the total cash selling prices and, like the finance charge, in percent of the total amount of original unpaid balances plus insurance. In spite of the variables which they include these average percentages show a sufficiently consistent pattern to warrant their presentation as two rough indices of the relative cost of insurance, as reflected in these samples of actual transactions.

According to the data obtained by the Federal Trade Commission, finance charges, expressed in annual percentage rates, ranged in the years 1935-38 from less than 12 to nearly 20 percent on new-car transactions, the variation arising from differences in company practices and from differences in contract lengths; in relation to original unpaid balance, plus insurance, the finance charge ranged from 6 to 10 percent on 12-month contracts. These data are presented in Table 55. The charges of the factory-controlled company

TABLE 55

FINANCE CHARGE AND INSURANCE PERCENTAGES SHOWN IN SAMPLES OF NEW-CAR TRANSACTIONS FINANCED BY SELECTED GROUPS OF SALES FINANCE COMPANIES, 1935–38[a]

Type of Finance Company	*Finance Charge*		*Insurance*		*Number of Transactions*
	In Annual Percentage Rate[b]	In % of Time Balance[c]	In % of Cash Selling Price[d]	In % of Time Balance[e]	
			12-MONTH CONTRACTS		
1935					
Factory-controlled[f]	14.6[g] *13.7*[g]	7.6[g]	2.6	5.1	896
Factory-preferred[j]	18.2 *16.8*	9.4	2.7	5.3	556
Independent	19.4 *17.9*	10.0	2.6	5.4	447
1936–38					
Factory-controlled[f]	11.5 *10.9*	6.0	2.5	5.3	1,456
Factory-preferred[j]	12.4 *11.8*	6.5	3.6	7.7	2,142
Independent	13.6 *12.8*	7.1	3.5	7.4	2,488
1938					
Factory-controlled[f]	11.7 *11.2*	6.1	2.5	5.6	427
Factory-preferred[j]	12.3 *11.6*	6.4	3.7	7.1	803
Independent	13.0 *12.1*	6.8	3.5	7.6	878
			18-MONTH CONTRACTS		
1935					
Factory-controlled[f]	14.4[h] *13.4*[h]	11.0[h]	4.0	6.4	1,558
Factory-preferred[j]	17.0 *15.7*	13.0	4.5	7.0	926
Independent	19.6 *18.0*	14.9	3.9	6.3	613
1936–38					
Factory-controlled[f]	11.6 *11.0*	9.0	3.6	6.2	2,019
Factory-preferred[j]	12.1 *11.5*	9.3	5.4	8.7	3,890
Independent	13.7 *12.8*	10.5	5.0	8.2	4,590
1938					
Factory-controlled[f]	11.6 *11.0*	9.0	3.7	6.6	569
Factory-preferred[j]	12.0 *11.4*	9.2	5.5	9.0	1,664
Independent	13.0 *12.4*	10.0	5.2	8.6	1,660

TABLE 55 (*continued*)

Type of Finance Company	*Finance Charge*		*Insurance*		*Number of Transactions*
	In Annual Percentage Rate[b]	In % of Time Balance[c]	In % of Cash Selling Price[d]	In % of Time Balance[e]	
		24-MONTH CONTRACTS			
1935					
Factory-controlled[f]	12.9[i] *12.2*[i]	13.2[i]	4.3	6.8	118
Factory-preferred[j]	16.4 *15.2*	16.7	6.5	9.0	28
Independent	10.6 *10.1*	10.8	6.5	10.3	137
1936–38					
Factory-controlled[f]	11.7 *11.2*	12.0	4.5	7.1	512
Factory-preferred[j]	12.0 *11.4*	12.3	6.5	9.5	4,705
Independent	12.8 *12.1*	13.1	6.6	9.6	5,353
1938					
Factory-controlled[f]	11.7 *11.2*	12.0	4.6	7.3	119
Factory-preferred[j]	11.9 *11.3*	12.2	6.9	10.2	896
Independent	12.0 *11.4*	12.3	7.0	10.5	939

[a] Based on Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) pp. 959, 968, 973-74, 976, 982, 985, 988.

[b] Rate of charge on the declining credit balance. In its report, cited above, the Federal Trade Commission defines "implied interest rate" as follows: "the monthly rate of interest is that rate which, applied to the original unpaid cash purchase price and to the successive reduced balances of the cash purchase price, . . . will just extinguish the unpaid balance with the application of the last installment," "each monthly installment being applied first to the extinction of the interest accrued during the month and the remainder of the installment to reducing the unpaid balance of the cash purchase price" (p. 952). The equivalent annual rate of interest implied in the finance charges "represents the interest on $1 compounded monthly at the monthly rate for 12 months" (p. 955). For the benefit of those who may object to this compounding process the Commission gives also an annual rate which is computed by multiplying the monthly rate by 12. In the present table both rates are given, the upper figure within the bracket representing the annual percentage rate compounded monthly, as described above, and the lower one (italicized) representing the alternative annual rate (12 times monthly rate).

Still another method of computing equivalent annual rates is contained in the formula $r = \frac{24c}{a(n+1)}$ in which c is the finance charge, a is the original unpaid balance plus insurance and n is the number of months the contract runs. This method is regarded by some statisticians as not so accurate as the

are shown to have been consistently lower than those of the other companies during this period;[10] the charges of the independent companies were highest. In 1938 the charges of all companies were conspicuously lower than they had been in 1935—a development due primarily to the introduction of the 6 percent plan.

Table 56 presents for used cars financed by these companies in 1936-38 the same data as Table 55 contains for new cars. For all types of companies, and for both 12-month and 18-month contracts, finance charges are shown to have been considerably higher for used cars than for new cars, the annual percentage rates ranging in these years from about

[10] With a single exception: in 1935 the independents' charges on 24-month contracts were notably lower than those of either of the other two types of companies.

Commission's preferred method, but it has the advantage of being easier to apply, since it does not necessitate complex mathematical procedures. It gives results which fall between those arrived at by the two methods mentioned above.

[c] Finance charge in percent of original unpaid balance plus insurance.

[d] This ratio varies according to several factors, such as territory, coverage and finance company practice, but these figures may be regarded as rough averages of the cost of insurance in relation to the original cash price of the car.

[e] Insurance in percent of original unpaid balance plus insurance. This percentage can be regarded only as a very rough index of the average cost of insurance in relation to the original instalment debt. Even in dollar amount insurance varies according to territory, coverage, finance company practice and type and price of car; and in percentage terms, as expressed here, it varies also according to original unpaid balance. Moreover, on 18-month contracts insurance is sometimes for 18 months and sometimes for two years, the purchaser having the option of cancelation for the last half year after his contract with the finance company has been paid in full. But in spite of such considerations these averages show a sufficiently consistent pattern to warrant their presentation as a rough index.

[f] General Motors Acceptance Corporation.

[g] For 240 transactions entered into in 1935 after the 6 percent plan went into effect the finance charge averaged 6.1 percent; the annual percentage rate it implied was 11.6 and 11.0 percent respectively.

[h] For 383 transactions entered into in 1935 after the 6 percent plan went into effect the finance charge averaged 9.0 percent; the annual percentage rate it implied was 11.6 and 11.0 percent respectively.

[i] For 37 transactions entered into in 1935 after the 6 percent plan went into effect the finance charge averaged 12.0 percent; the annual percentage rate it implied was 11.7 and 11.2 percent respectively.

[j] Commercial Investment Trust Corporation—including its subsidiary, Universal Credit Corporation—and Commercial Credit Company.

TABLE 56

FINANCE CHARGE AND INSURANCE PERCENTAGES SHOWN IN SAMPLES OF USED-CAR TRANSACTIONS FINANCED BY SELECTED GROUPS OF SALES FINANCE COMPANIES, 1936–38[a]

TYPE OF FINANCE COMPANY	12-MONTH CONTRACTS					18-MONTH CONTRACTS				
	Finance Charge		*Insurance*			*Finance Charge*		*Insurance*		
	Annual Percentage Rate[b]	% of Time Balance[c]	% of Cash Price[d]	% of Time Balance[e]	*Number of Transactions*	Annual Percentage Rate[b]	% of Time Balance[c]	% of Cash Price[d]	% of Time Balance[e]	*Number of Transactions*
Factory-controlled[f]	25.3 / *22.9*	12.8	2.9	6.9	194	17.5 / *16.2*	13.3	4.5	6.6	99
Factory-preferred[g]	30.9 / *27.2*	15.3	3.5	6.3	395	23.0 / *20.9*	17.4	5.0	7.4	485
Independent	37.2 / *31.9*	18.1	3.7	6.0	374	26.7 / *23.9*	20.0	4.7	6.8	341

[a] Based on Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) pp. 1032, 1036, 1039, 1043, 1047, 1050.
[b] Rate of charge on the declining credit balance. For explanation see Table 55, footnote b. The upper figure is the annual percentage rate compounded monthly, as described in Table 55, footnote b, and the lower one (italicized) is 12 times the monthly rate.
[c] Finance charge in percent of original unpaid balance plus insurance.
[d] This ratio varies according to several factors, such as territory, coverage and finance company practice, but these figures may be regarded as rough averages of the cost of insurance in relation to the original cash price of the car.
[e] Insurance in percent of original unpaid balance plus insurance. See Table 55, footnote e. In used-car transactions the cost of insurance is commonly added to the finance charge and is not, as here, expressed separately.
[f] General Motors Acceptance Corporation.
[g] Commercial Investment Trust Corporation—including Universal Credit Corporation—and Commercial Credit Company.

18 to 37 percent for the different types of companies and the different contract lengths; on 12-month contracts charges ranged from nearly 13 to 18 percent of original unpaid balance plus insurance. The relationships observed before for the three groups of companies are maintained here too, but in contrast to new-car financing, the percentage differential between the types of companies is here considerably greater on 18-month than on 12-month contracts. On 18-month used-car contracts the annual rate implied in the charges of independent companies was more than half again as high as that implied in the charges of the factory-controlled company.

That wide variations exist in the finance charges on individual transactions is evident from Table 57, which shows, for each type of company and for both new cars and used cars, the lowest and the highest charges shown in a sample of 12-month transactions. Thus a new-car transaction financed by an independent company is shown in which the annual rate implied in the finance charge was a negative 8.1 percent, the lowest cited in the table; there was also a used-car transaction, financed by an independent company, which carried a negative charge. At the other extreme may be noted a new-car transaction in which the finance charge amounted to an annual rate of 80.3 percent, and a used-car transaction in which it amounted to 132.1 percent. It should be remembered, however, that comparisons between groups are comparisons between extreme cases in those groups.

The considerable variations shown in this table may occur for several reasons. The very low charges are usually the result of a dealer's error in computation. The very high charges are caused for the most part by dealers' packs, sometimes also by an overcharge for insurance, through which the customer receives less protection than he pays for. In used-car financing a very high or very low percentage rate results often from the fact that used-car finance charges cus-

TABLE 57

LOWEST AND HIGHEST FINANCE CHARGE PERCENTAGES SHOWN IN SAMPLES OF NEW-CAR AND USED-CAR TRANSACTIONS FINANCED BY SELECTED GROUPS OF SALES FINANCE COMPANIES, 1935–38, AND ACCOMPANYING INSURANCE PERCENTAGES[a]

TYPE OF FINANCE COMPANY	TRANSACTION WITH LOWEST RATE OF CHARGE: Finance Charge: In Annual Percentage Rate[b]	Finance Charge: In % of Time Balance[c]	Insurance: In % of Cash Selling Price	Insurance: In % of Time Balance[d]	TRANSACTION WITH HIGHEST RATE OF CHARGE: Finance Charge: In Annual Percentage Rate[b]	Finance Charge: In % of Time Balance[c]	Insurance: In % of Cash Selling Price	Insurance: In % of Time Balance[d]	NUMBER OF TRANSACTIONS IN SAMPLES
NEW CARS									
Factory-controlled[e]	8.6 / *8.3*	4.5	...	....[f]	26.3 / *23.5*	13.2	.9	2.2[g]	745
Factory-preferred[h]	.5 / *.5*	.3	5.3	13.0[i]	80.3 / *61.4*	36.3	4.3	18.1[j]	939
Independent	−8.1 / *−8.4*	−4.5	6.7	43.1[k]	49.7 / *41.0*	23.6	2.0	5.5[m]	999
USED CARS									
Factory-controlled[e]	15.4 / *14.4*	8.0	3.6	4.9[n]	51.4 / *42.2*	24.3	...	....[o]	194
Factory-preferred[h]	.8 / *.8*	.4	1.4	2.2[p]	110.0 / *76.6*	46.1	3.1	4.3[q]	395
Independent	−7.3 / *−7.6*	−4.1	19.0	22.8[r]	132.1 / *87.2*	52.9	5.5	7.6[s]	374

[a] Based on Federal Trade Commission, *Report on Motor Vehicle Industry* (1939). In the samples containing these transactions all cars were sold on 12-month contracts. The used-car samples, which pertain to the years 1936-38, are identical with the sample of 12-month contracts in Table 56; the data on them are based on tables found on pp. 1032, 1036 and 1039 of the Federal Trade Commission report. The new-car samples, however, pertain to the years 1935 and 1938,

and cover not the entire eastern half of the country but only the following regions: 1935, North Central; 1938, North and South Central and North Atlantic. The data on these samples are based on tables found in the report on pp. 996-1020, *passim*.

[b] Rate of charge on the declining credit balance. For explanation see Table 55, footnote b. The upper figure is the annual percentage rate compounded monthly, as described in Table 55, footnote b, and the lower one (italicized) is 12 times the monthly rate.

[c] Finance charge in percent of original unpaid balance plus insurance.

[d] Insurance in percent of original unpaid balance plus insurance.

[e] General Motors Acceptance Corporation.

[f] Finance company did not place the insurance (see Federal Trade Commission report, p. 996).

[g] The major portion of insurance appears to have been placed by either the dealer or the purchaser (report, p. 997).

[h] Commercial Investment Trust Corporation—including Universal Credit Corporation—and Commercial Credit Company.

[i] The down payment was more than 60 percent of cash selling price, thus making for a high insurance percentage in relation to the base used here (report, p. 999).

[j] The down payment was more than 80 percent of cash selling price, thus making for a high insurance percentage in relation to the base used here (report, p. 1013).

[k] The down payment was more than 90 percent of cash selling price, thus making for a high insurance percentage in relation to the base used here (report, p. 1014).

[m] The down payment was nearly two-thirds of cash selling price and thus the insurance percentage, on the base used here, should have been relatively high. The fact that it was approximately average, while the finance charge percentage was much higher than average, indicates that the total charges included a greater insurance coverage than was actually provided (report, p. 1001).

[n] No irregularities apparent in the insurance charge (report, p. 1033).

[o] No insurance provided, since cash selling price was only $100; in such instances the finance charge is higher (report, p. 1034).

[p] In computing total charges (including insurance) the dealer committed an error against himself, and was charged with the amount of this error. It is not clear whether insurance coverage was coincidentally reduced (report, p. 1036).

[q] No irregularities apparent in the insurance charge (report, p. 1037).

[r] This transaction occurred in the New York area, where insurance rates are particularly high; in computing total charges the dealer committed an error against himself, and thus the purchaser obtained his car plus insurance for less than he would have had to pay if he had bought for cash (report, p. 1040).

[s] No irregularities apparent in the insurance charge (report, p. 1041).

tomarily comprise not only a percentage charge but also a flat dollar sum; this flat addition makes for a very high percentage rate when the unpaid balance is small, and for a relatively low rate when the balance is large. On very low-priced used cars it is customary to waive the insurance requirement and increase the finance charge, and this too, of course, raises the percentage rate, especially when the unpaid balance on such deals is small, as it usually is of necessity. A final explanation of high rates is accounting irregularities of one kind or another.

THE TREND IN AUTOMOBILE FINANCE CHARGES

Series representative of the trend of automobile finance charges over a period of years have never been compiled, and data adequate for such a purpose have not been assembled. From available information it has been possible to construct indices, however, showing relative variations of the insurance and finance charges on a single hypothetical transaction during the period 1924-38. These indices are presented in Table 58.

The finance charge data were obtained from a large sales finance company; annual premiums on required insurance were ascertained from insurance manuals through the courtesy of the National Automobile Underwriters Association. The combined charge, built up from these two sources, refers to the total cost of insuring and financing in Albany, New York, a $400 unpaid balance on a new Chevrolet car selling for $600, the contract running for 12 months. A change in the combined charge may reflect a change in the finance charge, in the insurance rate or in both.

Since insurance varies with make of car and region as well as with price it was necessary to standardize these factors as well as factors relating to the contract. Albany, New York,

TABLE 58

INDICES OF FINANCE CHARGES AND OF COMBINED INSURANCE AND FINANCE CHARGES ON A HYPOTHETICAL NEW-CAR TRANSACTION, FINANCE CHARGE IN PERCENT OF COMBINED CHARGE, AND INDEX OF THE GROSS TIME PRICE, 1924–38[a]

Year	*Finance Charge*[b]	*Combined Charge*[c]	*Finance Charge in Percent of Combined Charge*	*Gross Time Price*[d]
1924	105	87	75	99
1925	94	79	74	98
1926	98	108	56	101
1927	105	106	62	101
1928	105	106	62	101
1929	105	106	62	101
1930	105	108	61	101
1931	103	92	69	99
1932	124	122	64	102
1933	124	122	64	102
1934	108	111	61	101
1935	81	94	53	100
1936	80	84	59	99
1937	80	89	56	99
1938	81	93	54	99

[a] Based on an assumed contract, running for 12 months, covering a new $600 Chevrolet with an original unpaid balance amounting to $400, the transactions taking place in Albany, New York. Charges and insurance rates computed as of the end of the year.

[b] Computed from data furnished by a large sales finance company.

[c] Finance charge plus insurance for fire, theft and, after 1931, collision. Insurance costs computed from manual rates, supplied by the National Automobile Underwriters Association.

[d] $600 plus insurance and finance charge.

was chosen for the standard region because insurance rates there are neither exceptionally high nor exceptionally low. The price selected—$600 delivered—is purely arbitrary and at no time did it represent an exact price of a delivered Chevrolet in Albany. The fiction of such a price is neces-

sary, however, in order to have a consistent series of insurance charges.

The insurance coverage underwent considerable change during the period included in the table. Most sales finance companies have always required fire and theft insurance. The most popular theft insurance at the present time is the so-called broad coverage, applicable to all losses, including loss of accessories or equipment. But before 1931 a limited coverage, with a $50 deductible provision, was more popular, and in some regions full coverage could not be obtained. This was true in Albany during 1924-29, and therefore for these years the theft insurance rates included in the table pertain to limited coverage.

Today collision insurance is usually required, but this requirement has been general only since 1932. Practices regarding collision provisions have not become standardized, and consequently they vary widely from company to company, and for individual companies from year to year. Even today some companies require no collision insurance; others require $50 deductible, others $25 deductible; and a few companies require complete coverage. Probably the most popular collision insurance requirement under current practice is the $50 deductible, and premiums on this basis have been incorporated in the table from 1932 on.

The index of the finance charge is fairly reliable, being based on the practice of a large sales finance company whose requirements of its customers were presumably fixed with an eye to competitive needs. The insurance series, however, is not altogether satisfactory as an indication of trends, because it might have been different in other areas. Thus the index of the combined charge, while it may be accepted as a fair reflection of actual practice, can be regarded in this way only with reservations.

With this qualification, the table reveals several striking tendencies. The index of combined charges shows a very

sharp rise in 1926, and thereafter continues at a fairly even level until its abrupt fall and still more abrupt upswing in the depression years 1931-32. Its subsequent decline, though slightly reversed during 1937 and 1938, shows that the widely noted decrease in automobile finance charges during recent years has reduced total costs to levels approximating those that prevailed in the middle 1920's, but has not established new low levels. Account must be taken, however, of the fact that the combined charge included a broader insurance coverage after 1931 than it did before. Thus, for about the same total cost, the instalment purchaser in 1938 obtained a larger bundle of services than he did fifteen years earlier.

A comparison of the combined-charge index with that for finance charge alone indicates the relative importance of insurance as a reason for the variations that appear. In the first two years covered by these series the insurance cost constituted about one-quarter of the combined charge; from 1926 through 1934 insurance amounted, roughly, to a little less than two-fifths of the combined charge, and after 1934 it was somewhat more than two-fifths. Thus in this period the fraction of the combined charge that is represented by insurance shows a fairly steady increase. It appears that the sharp rise in combined charges in 1926 was due mainly to insurance, and that while insurance costs decreased in the following year the drop was almost counteracted by a rise in finance charges. Similarly, the conspicuous decrease in combined charges in 1931 was due mainly to a sharp fall in insurance costs, but the still more conspicuous increase of the following year resulted from substantial rises in both insurance and finance charges. In 1934 and 1935 it was finance charges, in 1936 and 1937 it was insurance, that produced the variations in combined charges; the slight rise in 1938 was the result of increases in both items.

There is a further feature of finance charge behavior which is of considerable significance in the competitive relation-

ships of sales finance companies, to be discussed in Chapter 11. It should be noted here, however, that even wide swings in the combined-charge index make but a small difference in the index of gross time price. To cite the extreme swings in the two series, the combined-charge index rose from 92 in 1931 to 122 in 1932, and fell to 84 in 1936. The corresponding values in the index of gross time price for this new low-priced car were 99, 102 and 99. This disproportion between relative changes in the cost of instalment financing and the consequent relative changes in the total time price may explain in part the resistance of sales finance companies to active "price" (finance charge) competition, for no single sales finance company is likely to assume the lead in reducing customer finance charges unless it expects that even if competitors do likewise it will reap an increase in retail volume.

In retail instalment transactions charges for financing services and insurance are necessarily merged with the price of the commodity; since charges represent only a fraction of the total instalment price that the consumer pays, any percentage change in the finance charge will produce only a smaller percentage change in the total price paid. Unless potential instalment buyers respond in great numbers to small percentage decreases in total time price (that is, unless the elasticity of demand for instalment sales is very great), such decreases—resulting from a large percentage reduction in the combined charges—will only produce a lower gross income for sales finance companies. And conversely, if consumers are not significantly deterred by small percentage increases in total time price—resulting from large percentage increases in charges—the result will be a higher income for the finance companies. It would appear, however, that purchasers' response to percentage differences in the total time price is a variable factor. The trend of combined charges during the last decade, when the sales finance business had

passed its initial period of rapid expansion, suggests a conclusion on the part of the trade that in severe depression years the number of potential instalment buyers will not be greatly affected by a higher level of charges, but that in years of recovery this factor may have a significant influence on business.

QUOTATION OF CHARGES IN DIVERSIFIED FINANCING

In diversified financing, too, charges are usually quoted as so many dollars of charge on specified original unpaid balances, although there appears to be increasing variation in practice. Retail financing plans of sales finance companies are necessarily in competition with plans of merchants who handle their own paper and have developed their own instalment practices, and data made specially available to us, covering a small number of leading department stores, indicate that predominant practice among such dealers is to charge a straight ½ percent per month on the original unpaid balance on appliances, furniture and other durable goods items. In diversified financing it is not customary to impose on the purchaser a special charge for insurance protection.

Table 59 presents a comparison, in terms of dollar amount and also in terms of annual percentage rate, of the quoted charges of twelve private companies and the Electric Home and Farm Authority; the charges shown here are samples taken from rate charts in use at various times during the period 1936-38. The lowest amount of original unpaid balance represented in these data is $50, though rate charts sometimes make provision for smaller balances, with a maximum contract length of 6 months.

For all amounts of unpaid balance and for all contract lengths the government agency, EHFA, showed an annual

TABLE 59

DOLLAR AMOUNT AND ANNUAL PERCENTAGE RATE OF FINANCE CHARGES QUOTED IN THE DIVERSIFIED FINANCING OF 12 SALES FINANCE COMPANIES AND ELECTRIC HOME AND FARM AUTHORITY, 1936–38, BY AMOUNT OF ORIGINAL UNPAID BALANCE AND LENGTH OF CONTRACT[a]

Company	*$50*		*$100*			
	12 Months		12 Months		24 Months	
National						
A	..	..	$ 9.68	(17.9%)	$15.20	(14.6%)
B	$7.00	(25.8%)	$ 8.96	(16.5%)	$15.20	(14.6%)
B[b]	*$9.04*	*(33.4%)*	*$11.00*	*(20.3%)*	*$17.36*	*(16.7%)*
C	$7.84	(28.9%)	$ 9.08	(16.8%)	$15.20	(14.6%)
C[b]	*$8.68*	*(32.0%)*	*$10.76*	*(19.9%)*	*$16.88*	*(16.2%)*
D	$7.00	(25.8%)	$ 8.96	(16.5%)	$15.20	(14.6%)
E	$7.00	(25.8%)	$ 8.96	(16.5%)	..	..
Regional						
F	$7.00	(25.8%)	$ 8.24	(15.2%)	$14.72	(14.1%)
Local						
G	$5.20	(19.2%)	$ 8.60	(15.9%)	$16.88	(16.2%)
H	..	..	$ 7.50	(13.8%)	..	..
I	$8.20	(30.3%)	$12.68	(23.4%)	$21.92	(21.0%)
I[c]	*$7.04*	*(26.0%)*	*$10.40*	*(19.2%)*	*$19.52*	*(18.7%)*
J	$7.00	(25.8%)	$ 9.56	(17.6%)	$14.96	(14.4%)
K	$7.84	(28.9%)	$ 9.08	(16.8%)	$15.20	(14.6%)
L	$7.00	(25.8%)	$ 8.60	(15.9%)	$18.80	(18.0%)
L[d]	*$8.56*	*(31.6%)*	*$10.16*	*(18.8%)*	*$22.16*	*(21.3%)*
EHFA	$2.56	(9.5%)	$ 5.00	(9.2%)	$ 9.92	(9.5%)

Company	*$200*					
	12 Months		24 Months		30 Months	
National						
A	$11.92	(11.0%)	$23.92	(11.5%)	$29.80	(11.5%)
B	$13.00	(12.0%)	$23.92	(11.5%)	$30.10	(11.7%)
B[b]	*$16.96*	*(15.7%)*	*$28.00*	*(13.4%)*	*$34.00*	*(13.2%)*
C	$15.04	(13.9%)	$23.92	(11.5%)	$29.80	(11.5%)
C[b]	*$18.28*	*(16.9%)*	*$27.52*	*(13.2%)*	*$33.40*	*(12.9%)*
D	$13.00	(12.0%)	$23.92	(11.5%)	$29.80	(11.5%)
E	$13.00	(12.0%)	$24.16	(11.6%)	$30.10	(11.7%)
Regional						
F	$12.04	(11.1%)	$23.92	(11.5%)	$29.80	(11.5%)
Local						
G	$16.96	(15.7%)	$34.24	(16.4%)	..	..
H	$12.00	(11.1%)	$24.00	(11.5%)	$30.00	(11.6%)
I	$21.40	(19.8%)	$34.00	(16.3%)	..	..
I[c]	*$16.96*	*(15.7%)*	*$29.20*	*(14.0%)*	..	..
J	$15.04	(13.9%)	$24.88	(11.9%)	$31.00	(12.0%)
K	$15.04	(13.9%)	$23.92	(11.5%)	..	..
L	$15.40	(14.2%)	$28.00	(13.4%)	..	..
L[d]	*$18.40*	*(17.0%)*	*$33.52*	*(16.1%)*	..	..
EHFA	$10.00	(9.2%)	$20.08	(9.6%)	$25.00	(9.7%)

TABLE 59 (*continued*)

Company	$300					
	12 Months		24 Months		30 Months	
National						
A	$18.00	(11.1%)	$36.00	(11.5%)	$45.00	(11.6%)
B	$18.00	(11.1%)	$36.00	(11.5%)	$45.00	(11.6%)
B[b]	*$24.00*	*(14.8%)*	*$42.00*	*(13.4%)*	*$51.00*	*(13.2%)*
C	$18.00	(11.1%)	$36.00	(11.5%)	$45.00	(11.6%)
C[b]	*$22.80*	*(14.0%)*	*$41.04*	*(13.1%)*	*$50.40*	*(13.0%)*
D	$18.00	(11.1%)	$36.00	(11.5%)	$45.00	(11.6%)
E	$18.00	(11.1%)	$36.00	(11.5%)	$45.00	(11.6%)
Regional						
F	$18.00	(11.1%)	$36.00	(11.5%)	$45.00	(11.6%)
Local						
G	$25.56	(15.7%)	$50.88	(16.3%)	..	..
H	$18.00	(11.1%)	$36.00	(11.5%)	$45.00	(11.6%)
I	$30.00	(18.5%)	$48.72	(15.6%)	..	..
I[c]	*$23.40*	*(14.4%)*	*$41.76*	*(13.4%)*	..	..
J	$18.96	(11.7%)	$36.96	(11.8%)	$45.90	(11.8%)
K	$18.00	(11.1%)	$36.00	(11.5%)	..	..
L	$21.00	(12.9%)	$39.00	(12.5%)	..	..
L[d]	*$25.50*	*(15.7%)*	*$45.00*	*(14.4%)*	..	..
EHFA	$15.00	(9.2%)	$30.00	(9.6%)	$37.50	(9.7%)

[a] Prepared by Leonard R. Koser of the staff of Electric Home and Farm Authority, and based on compilations of rate schedules in effect at various times during the period 1936-38. For the most part the charges given are those effective on September 1, 1937, and are full recourse unless otherwise noted. By "annual percentage rate" is meant the ratio of finance charge to average amount of credit outstanding during the year, expressed as a percentage. It is here computed according to the formula $r = \frac{24c}{a(n+1)}$. See Table 55, footnote b.

[b] Limited recourse, restricted to defaults within four months.

[c] Discount plan: a 2 percent discount is allowed on each instalment paid on or before date of maturity. The second set of figures assumes that 2 percent discount is allowed on each monthly instalment.

[d] This company offers a "term life insurance" plan, providing for the payment of unpaid balance of contract in case of death from any cause. A customer "electing" to take insurance pays the premium as part of finance charges.

percentage rate that varied between very narrow limits—from 9.2 to 9.7 percent—and in all categories this rate was lower than that of any private company. For the smallest balance represented in the table—$50, carrying a 12-month contract—the EHFA rate was 9.5 percent as compared with rates ranging from 19.2 to 28.9 percent for private finance companies which, like EHFA, accepted only full recourse

paper. The differential between EHFA and the private companies was smaller on larger balances and on longer contracts; for a $300 balance and a contract running 30 months full recourse private companies showed an annual rate of 11.6 percent (in one case 11.8) as against EHFA's 9.7 percent. Among the private companies annual rates are shown to be more uniform for higher balances and longer contracts.

There has been a tendency in recent years for diversified finance companies to offer limited liability plans under which the liability of dealers is limited to the span of four or six monthly payments, provided those payments are made when due. Charges on two such plans, offered by national companies, are included in Table 59. In each case, for all amounts of original unpaid balance and for all contract lengths, an extra charge is assessed against consumers; this extra amount is presumably, though not necessarily, commensurate with the increased risk run by the finance company. A variation on such plans, with one rate schedule for standard-term contracts and another higher-charge schedule for substandard contracts, is in vogue with some companies.

Two other variations in the form of rate quotation are included in this table. Company I, a high-charge company, allows a 2 percent discount on each instalment paid on or before due date. Without the discount this company's straight charge runs substantially higher than those of other companies, but with the discount it approximates them fairly closely. Company L offers a term life insurance plan providing for repayment of the unpaid balance in case of customer's death for any cause. The customer, electing to take insurance, pays an excess charge presumably equal to the insurance premium rates.

9

Abuses in Retail Instalment Financing, and Their Regulation

For many years the financing practices of the retail instalment system have been subjected to severe criticism. The system has been attacked for its ambiguous form of quoting finance charges to consumers, for the exorbitant charges it has sometimes imposed and for the various deceptive and misleading practices, verging on fraud and occasionally actually fraudulent, in which some participants in the business have engaged, abetted by consumer ignorance and inertia. The present chapter examines the abuses which underlie such criticism in relation to the remedies that have been adopted or proposed as means of dealing with them. A summary of court decisions pertaining to retail sales financing will not be attempted, however, nor will legislation which relates indirectly to this field be discussed.

So far only four states—Indiana, Maine, Michigan and Wisconsin—have taken legislative action specifically regulating retail instalment financing.[1] There are significant dif-

[1] Indiana, Retail Installment Sales Act; Maine, An Act Regulating Automobile Finance Business; Michigan, An Act to Regulate Retail Installment Sales Contracts Covering Motor Vehicles . . . ; Wisconsin, Law Relating to the Licensing of Motor Vehicle Dealers, Motor Vehicle Salesmen, Sales Finance Companies. In citations these laws are hereafter referred to as Indiana Act, Maine Act, Michigan Act and Wisconsin Act. Pennsylvania has a Consumer Discount Company Act which has somewhat the appearance of a general instalment sales law covering the regulation of sales finance companies. Section 17, however, exempts banking institutions and small loan companies, and states that the law does not apply to "any bona fide sale of personal property by a person regularly engaged in the sale of such personal property, wherein the purchaser may pay any part or all of the

ferences among these laws in regard to institutional coverage and administrative supervision. The Indiana law, the first to be passed (1935), applies in most of its provisions to the whole field of retail instalment financing, and requires the licensing of all businesses engaged in the purchasing of instalment contracts. The Maine law (1939) provides for the licensing of businesses engaged in financing time sales of motor vehicles. The Michigan law (1939) contains no licensing feature but it regulates instalment sales contracts covering motor vehicles. The Wisconsin law (1935, amended 1937) is also confined to businesses engaged in motor vehicle distribution, and it requires the licensing of dealers, salesmen, motor vehicle manufacturers and their representatives, and sales finance companies. The laws of Indiana and Wisconsin delegate to state supervisory authorities—the Department of Financial Institutions in Indiana, and the State Banking Commission in Wisconsin—broad powers of supervision over the conduct of business by licensees and also powers to issue such rules and regulations as may be necessary for enforcement. The Maine law is primarily a licensing act, and while the insurance commissioner can refuse to issue or renew a license after investigation if an applicant is not of good repute, or has been guilty of business practices that are fraudulent or unfair to the public, the law does not provide for general regulation or supervision.

Although only four states have taken specific legislative action in regard to retail instalment financing, such legislation has been proposed in several other states.[2] Also, there

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purchase price in stated installments, nor to any such bona fide sale under a conditional sale contract, lease or bailment, wherein the purchaser, lessee or bailee has the option of becoming, or is bound to become, the owner of the property upon full compliance with the terms of the agreement." This latter provision has been interpreted by the State Department of Banking to mean that sales finance companies are not covered by the act. Thus the law applies only to industrial banking companies, although such organizations are not mentioned specifically by name.

[2] For an account of the proposals set forth in New York, for example, see

have been various attempts, both within and without the trade, to establish regulations which would apply to the entire business, throughout the country. Under the National Industrial Recovery Act the sales finance business itself attempted a codification of trade practices in 1933. This effort was unsuccessful, mainly because of an inability to reach agreement on the problems of dealer payments and finance company relationships with manufacturers, and the controversy was responsible for the formation of the Mid-West Finance Conference (now the American Finance Conference) as a trade association independent of the older National Association of Finance Companies (now the National Association of Sales Finance Companies). These two associations, however, have given serious consideration to the problem of self-regulation, and have devised lists of "approved trade practices" to assist in this purpose. Also, the Credit Management Division of the National Retail Dry Goods Association has striven to improve and standardize the practices of retail merchants in extending instalment credit, and to this end has collaborated with the other organizations that have similar aims.

There is an increasing conviction among sales finance company officials and retail dealers that some measure of uniform legislative regulation is needed in this field. Representatives of the National Association of Sales Finance Companies and of the National Retail Dry Goods Association are working on a draft of a new uniform conditional sales act, to be submitted to all trade associations interested in instalment credit regulations. Also, proposals have been made regarding a uniform law which would provide for the licensing of sales finance companies; possible provisions of such a law have already been drafted and, through the

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"Installment Practices Under Fire—New York Attorney General and Legislators Urge State Regulation" in *Personal Finance News*, vol. 24, no. 10 (April 1940) pp. 17 ff.

medium of trade journals, submitted to the sales finance business for its consideration.[3] Both of these proposed laws would be framed in such a way as to apply not only to sales finance companies and retail merchants but also to commercial banks, industrial banking companies and small loan companies, to the extent that they engage in the business of financing instalment sales.

In April 1938 the Federal Trade Commission, upon application of members of the automobile industry, held a conference regarding trade practices in that industry, and on this basis it has drafted proposals for the consideration of those interested;[4] some of the proposals pertain to the business of sales financing in the automobile field. As a preliminary to a final draft of these rules public hearings on them were held on March 20, 1940. At the present time the predominant attitude of the industry is to favor self-regulation, without government participation.

In the following pages the provisions of these various existent and proposed laws and regulations will be discussed in relation to the specific abuses they are designed to correct.

AMBIGUITY OF RATE QUOTATION

In the days of the National Recovery Administration the Consumers Advisory Board was extremely critical of the usual forms of rate quotation in instalment selling, and tried unsuccessfully to have provisions inserted in the various codes proposed for the retail instalment field requiring

[3] See Milan V. Ayres, "A Suggested Uniform Sales Finance Company Licensing Act" in *Time-Sales Financing*, vol. 4, no. 7 (July 1939) pp. 10-12; also "Comments on Suggested Finance Company Licensing Act" in *Time-Sales Financing*, vol. 4, no. 9 (September 1939) p. 7.

[4] Federal Trade Commission, "Proposed Trade Practice Rules for the Automobile Industry," released February 19, 1940. For a comparison of these proposals with those adopted at the industry conference in 1938 see "Proposed Fair Trade Practice Rules for the Automobile Industry" in *N.A.D.A. Bulletin*, published by the National Automobile Dealers Association, vol. 12, no. 5 (March 1940) pp. 10 ff.

that charges be stated in the form of a percentage on the current unpaid credit balance; by this form of quotation consumers would be enabled to compare costs of alternative kinds of credit, and costs of the same kind of credit offered by different seller-lenders.

In recent years various state supervisory and legislative committees have considered the charge problem and have generally voiced agreement with the position taken by the Consumers Advisory Board. The Indiana Department of Financial Institutions, for example, recommended in 1935 that all charges other than insurance be stated as a percent per month of the unpaid credit balance, "in order that prospective buyers may determine readily the cost as compared with borrowing from a small loan agency."[5] In 1936 the Massachusetts Committee on Consumer Credit, while approving as a vast improvement the percentage basis of stating finance charges introduced by the larger companies, stated that "any method short of an accurate, uniform statement of charges on a true interest rate basis, such as a percent per month on actual, unpaid balances, is unsatisfactory."[6] In Wisconsin the Interim Advisory Legislative Committee to Investigate Finance Companies similarly reported in 1935 that a percent per month form of rate charge, like that recommended in the Uniform Small Loan Law, was the fairest way of acquainting the consumer with the facts, but stated that any immediate change to such a plan would be costly and "likely to work irreparable damage" to the sales finance business.[7]

Spokesmen for sales finance companies, however, stoutly

[5] Report of the Indiana Department of Financial Institutions, *Indiana Consumer Finance Agencies* (ms. 1935) p. 44.

[6] *Report of the [Massachusetts] Committee on Consumer Credit* (1936) p. 13. The Massachusetts Committee, p. 25, points out that this form of rate quotation has been approved by various social and economic groups.

[7] *Report of the [Wisconsin] State Banking Commission and Interim Advisory Legislative Committee to Investigate Finance Companies* (1935) p. 42.

deny the need for an "effective interest" quotation of charges. They insist that for most purposes it is sufficient if the consumer knows the dollar amount of finance charge, and they affirm that there is a fundamental distinction between a time sale and a loan, a difference which makes it inappropriate to quote the finance charge as a rate of interest. Their position is of course based on the assumption that if charges were quoted as interest they would be interpreted as interest, and therefore be subject to laws regulating interest. They justify their present freedom from such regulation on the ground that their charges are necessarily higher than commercial interest rates, and on the ground that discount transactions, at rates higher than prevailing interest, are constantly entered into by banks and other commercial organizations. In this they have been generally upheld by the courts, which have declared that a discount transaction, such as that entered into by a sales finance company when it purchases an instalment contract from a dealer, is not an interest transaction.

No legislation thus far enacted attempts to stipulate the form in which the finance charge should be quoted to the consumer. The Wisconsin advisory report declared that in view of the legal and practical difficulties involved in requiring an interest form of quotation the most important immediate need was to state clearly to consumers the various elements of charge in instalment transactions and thus encourage a better informed competition. It therefore recommended that the state banking authorities should have power to impose definite requirements "to the end that the differential between the cash and the sale price be clearly stated in a memorandum to the consumer as well as finance charges, including any 'pack,' rebate, or reserve, and a separate statement of insurance charges."[8] Also the Massachusetts

[8] *Ibid.*, p. 61.

Committee on Consumer Credit recommended that these items be clearly specified in the instalment contract.

Of the existent laws those of Indiana, Michigan and Wisconsin require that the consumer be apprised in some detail regarding the various terms of the transaction, including actual insurance and the finance charge (in the Wisconsin act, any charge), and be furnished with a written copy thereof.[9] Under the Wisconsin act two memoranda are required to be furnished to the purchaser. At the time an order is taken in a motor sales transaction the dealer must furnish the purchaser with a memorandum explaining the elements of the transaction. Since the dealer, however, may not be in a position to break down the overall charge into the cost of insurance coverage and the finance charge proper, the sales finance company is required to furnish a further memorandum within thirty days after acquisition of a contract, showing this breakdown and including a copy of the insurance policy or a certificate of insurance.[10]

The need for a separate statement of insurance charges is widely recognized, within as well as without the trade, and existing suggestions for a uniform finance company licensing act include a provision to this effect. As has been mentioned, it is now the practice—mainly of national companies—to state the insurance charge separately from the finance charge in new-car financing. And it is the practice of at least one large national company to state in rate charts for both new and used cars the dollar amount of charge; in new-car rate

[9] Indiana Act, sect. 4; Michigan Act, sect. 2; Wisconsin Act, sect. (6) (b) and (e).

[10] In the administration of the law it has been found, according to John F. Doyle, Supervisor of the Division of Consumer Credit of the Wisconsin State Banking Department (letter dated October 31, 1939), that when a contract is sold to or discounted with the finance company, the figures which the dealer submits have sometimes been materially altered from those in the memorandum he gave the purchaser, either in order to mislead the finance company as to the amount of the down payment that was received from the purchaser, or in order to obtain a pack on the finance charges.

charts the insurance premium is added to the original unpaid balance, and in used-car rate charts it is included with the finance charge.

EXORBITANT FINANCE CHARGES

Criticism of sales finance companies for exorbitant charges, both for financing and for insurance, is particularly widespread, especially in reports made on this subject by public groups. Efforts to regulate charges are often discussed, but so far only the Indiana law has attempted to set maximum legal rates. This law provides for the administrative determination of maximum charges, and this has been carried out by the Department of Financial Institutions. Its schedule includes a flat percentage charge on the original unpaid balance, varying from 2 percent (new merchandise) to 5 percent (used merchandise), plus a charge of 2 to 3 percent per month on the current unpaid balance;[11] and the law permits lawful fees, such as delinquency charges, in addition to the legal finance charge.[12] The constitutionality of these regulations has not been finally determined.

The Wisconsin act states that interest shall not be charged in excess of 15 percent per annum,[13] but this provision is held to be meaningless since the state usury law prohibits any interest rate above 10 percent per annum; moreover, this clause refers only to interest transactions (such as the imposition of delinquency fees) and makes no specific provision as to the status of the finance charge that is added in a time payment sale.[14] The State Banking Commission

[11] Indiana Department of Financial Institutions, *General Order No. 1* under the Indiana Act, pp. 1-6.
[12] Indiana Act, sect. 7.
[13] Wisconsin Act, sect. (6) (h).
[14] Letter from John F. Doyle, Supervisor of the Division of Consumer Credit, Wisconsin State Banking Department, October 31, 1939.

has ruled that documentary or filing fees may be included in the finance charge.[15]

The proposed uniform licensing law provides that finance companies should file, with a designated official, copies of their effective rate schedules, and that these schedules should be open to public inspection. They should show "the finance charge, and the insurance charge, or the sum of these two charges, or a method of computing said charges for every original unpaid balance and every period of time."

As to the matter of consumer protection against excessive insurance charges, legislation so far enacted generally sets standard manual premium rates as the maximum. The Indiana law makes no provision for maximum insurance rates, but provides that the instalment buyer may deduct from his last instalment payment any excess insurance premium over that fixed on insurance of like kind and amount in the published manual of a standard rating bureau designated by the retail seller.[16] The Michigan law specifies that any retail buyer shall have the right to purchase his insurance from any person, and that no retail seller shall coerce, threaten or in any manner influence him in his choice of where he will buy.[17] The Wisconsin law specifies that the premiums fixed shall not exceed rates fixed in the published manual of a rating bureau of recognized standing.[18]

Insurance charges, however, are regulated not only in sales finance company legislation but also in insurance legislation, and it is reported that in 1938 and 1939 insurance commissioners in twenty-eight states issued rulings requiring that rates and coverages be detailed to customers.

Regulation of dealers' participation in finance charges is another feature of the present laws. Under Indiana legisla-

[15] Wisconsin State Banking Commission, Regulation of Licensees under the Wisconsin Act (1939) Rule 7 (g).

[16] Indiana Act, sect. 5.

[17] Michigan Act, sect. 2.

[18] Wisconsin Act, sect. (6) (e).

tion the Department of Financial Institutions has ruled that dealer participation in the finance charge may not exceed 2 percent of the original unpaid balance on new merchandise and 5 percent on used merchandise.[19] The Wisconsin law merely forbids unconscionable acts, but the State Banking Commission, which is responsible for regulation of motor vehicle sales financing under the law, has declared that dealer participation beyond 2 percent on new-car deals and 3 to 5 percent on used-car deals is unconscionable.[20]

Efforts of the sales finance business itself to settle the problem of dealer payments have been complicated by the related problem of factory affiliations with finance companies, which will be discussed in Chapter 11. It was mainly these issues that caused the failure of the efforts made in 1933 to establish an NRA code for the sales finance business, the independent companies contending that the larger companies' suggestions regarding dealer payments would only intensify the "monopolistic" situation.[21] In recent controversies over the issue the American Finance Conference, representing the independents, has taken the stand that all dealer participation should be eliminated from the finance charge by all companies, and has placed itself on record to that effect with the United States Department of Justice.[22]

Both codes of trade practices drawn up by the two sales finance company associations condemn the dealer's pack, and the American Finance Conference code declares that there should be no "excessive dealer participation" in the finance charge. The proposals made by the Federal Trade Commission, which are intended, after conference with interested

[19] Indiana, *General Order No. 1* (cited above) p. 6.
[20] Wisconsin, Regulation of Licensees (1939) (cited above) Rule 8 (c) (1).
[21] For an account of the code hearings and the issues involved see David F. Cavers, "The Consumer's Stake in the Finance Company Code Controversy" in *Law and Contemporary Problems*, published by Duke University, vol. 2, no. 2 (April 1935) pp. 200-17.
[22] Letter from F. V. Chew, Executive Vice President of the American Finance Conference, February 29, 1940.

persons, to be drafted into rules, provide that packing shall be construed as an unfair trade practice. And the suggestions for a uniform licensing act, which are being considered by the trade, provide for elimination of the pack and for limitation of the dealer's bonus to 1½ percent of original unpaid balance, or $5, whichever is greater.

ABUSES IN CONTRACT ADJUSTMENT

In connection with the performance of instalment contracts criticism has been directed at abuses and lack of standard practice in regard to delinquency, refinancing and the refunding of excess finance and insurance charges occasioned by prepayments. Delinquency abuses consist mainly in the imposition of excessive delinquency fees, collection of which is obtained under the threat of peremptory repossession. Refinancing abuses consist in the practice of extending or refinancing distressed deals only with a finance charge at least as high as the original charge, or at some flat charge fixed in accordance with what the customer can pay, though some of the larger companies extend or refinance contracts at the legal rate of simple interest.[23] Refinancing abuses also trace back to the origin of the contract, when the purchaser may have been induced to join in a deal carrying for him impossible maturity and monthly payment terms, thus necessitating later refinancing, or may have been persuaded—with eventual refinancing similarly necessitated—to participate in a balloon contract, that is, one with a few monthly payments terminated by one large payment.[24] Failure to make propor-

[23] This difference in practice results largely from differing conceptions of the applicability of the legal distinction between a time-sales transaction and a loan of money.

[24] See Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 951. At least one automobile dealer, according to the Federal Trade Commission, makes all deferred payment sales on balloon notes in order to obtain the benefits of refinancing.

tionate refund of the unearned part of the finance charge and of the unexpired insurance premium charge in the event of prepayment of contract is especially stressed as a common abuse in all three of the state legislative reports on instalment financing which were referred to above.

Of the laws so far enacted only those of Indiana and Wisconsin deal specifically with these abuses in contract adjustment. The Indiana act provides that the seller may specifically contract for "lawful delinquent charges,"[25] and the Department of Financial Institutions has fixed delinquency charges on a flat scale graduated both by amount of payment delinquent and by number of days delinquent.[26] The Wisconsin law makes no reference to the problem, other than its general prohibition of any unconscionable practice.[27]

For cases of purchaser difficulty in which refinancing might provide a remedy the Indiana law lays down no procedure. The Department of Financial Institutions has notified its licensees, however, that an unperformed contract may be modified by agreement of the parties in order to extend the time and manner of payment, so long as the finance charge does not exceed that which would have applied if the original contract had extended for the longer period.[28] Wisconsin finance companies are not allowed to make direct loans or to refinance accounts at financing charges in excess of 6 percent per annum simple interest (without contract) or 10 percent per annum simple interest (under contract) unless they are licensed as direct loan companies.[29]

Refunding of unearned interest and insurance premiums is specified by both Indiana and Wisconsin laws or regula-

[25] Indiana Act, sect. 6.

[26] Indiana, *General Order No. 1,* pp. 6-7.

[27] Wisconsin Act, sect. (3) (a) 11.

[28] Notification to licensees by the Department of Financial Institutions, October 15, 1936.

[29] Wisconsin State Banking Department, Division of Consumer Credit, General Instructions to the Wisconsin Act.

tions thereunder. Indiana requires that a minimum of 1 percent per month of the finance ("discount") charge be refunded to the purchaser on each instalment prepaid, if prepayment is made of the balance of the contract, and also that there be a full rebate of the unexpired insurance premium.[30] Wisconsin regulations require a refund of unearned insurance, but companies are required merely to file a statement of their schedule of refunds.[31]

Both the efforts at self-regulation and the proposals for legislative and administrative regulation give considerable emphasis to provisions regarding contract adjustment. The trade association codes of fair practices, the proposed licensing act, and the Ford-Chrysler consent decree provisions regarding registration of finance companies[32] all provide for limitation of delinquency fees. Provisions for rebate of finance charges and insurance premiums in case of prepayment are contained in the codes and the proposed law, and provisions limiting the charges for extending or refinancing a contract are contained in the consent decrees and the proposed law.

OTHER ABUSES

Many other business practices which have developed in conjunction with the instalment system have also been a source of criticism.[33] Hasty or peremptory repossession, for example, has been encouraged by the possibility of high reinstatement fees in the event that the purchaser reclaims his collateral, and in some states purchasers have had no protection of their equity in the event of unwarranted repossession and

[30] Indiana Department of Financial Institutions, *General Order No. 2* under the Indiana Act.

[31] Wisconsin, Regulation of Licensees (1937) Rule 7 (c) and (e).

[32] See Chapter 11, pp. 273-74.

[33] See in this connection the Massachusetts *Report* (cited above) pp. 41-45, and the Wisconsin *Report* (cited above) pp. 33-49.

resale. Some companies have been known to impose fees for services on purchasers who were erroneously traced as fraudulent fugitives or "skips."

Another practice severely criticized is that of the add-on contract, under which purchasers may finance an additional purchase before the original purchase is fully paid off, with both purchases serving as collateral security for the instalment note; thus in the event of default both purchases may be repossessed, even though payments may more than cover the unpaid balance on the original.[34]

Still other complaints have been lodged against the instalment system for the practice, engaged in by some finance companies, of demanding extra security in the form of chattel mortgages on non-sale merchandise, endorsements of other parties, or wage assignments.[35] When such extra security is provided, the purchaser may be subject to considerable pressure to acquiesce in any delinquency or reinstatement fees that may be imposed.

Finally, the instalment system is criticized for such abuses as inadequate contracts, miscellaneous deceptions and outright frauds. In no area of the system are these aspects of practice more forcefully illustrated than in the automobile field in connection with insurance. In the first place, the dealer's pack has been tolerated in some cases as an addition to the insurance charge, simply because this charge affords a convenient spot to conceal the pack. Further, in some cases insurance specified under the instalment contract has not been actually provided and delivered. State insurance departments have reported that many such instances occur, but that discovery of the absence of insurance is not made until after an accident has occurred and the purchaser finds himself unprotected.

[34] Edward L. Greene, "Better Business Bureau Activities in Aid of the Time Purchaser" in *Law and Contemporary Problems*, published by Duke University, vol. 2, no. 2 (April 1935) p. 255.
[35] *Ibid.*, pp. 255-56.

Another complaint confirmed by state insurance departments is that insurance contracts are sometimes so written that protection is severely restricted under policy terms, though the purchaser is led by the policy title to assume a particular type of protection.[36] One of the companies examined by the Federal Trade Commission, in its investigation of the motor vehicle industry, made a regular practice of charging full conference rates for the usual type of protection but delivering only severely restricted protection; the difference, amounting on the average (58 deals, 1937-38) to about 21 percent of the amount charged, was pocketed by the finance company.[37] The Federal Trade Commission also mentions that when dealers or purchasers elect to place insurance elsewhere than through the finance company, the deduction from total finance charges allowed is often only the wholesale cost of the insurance to the finance company, not the entire retail premium.[38]

A further set of problems arises because many companies place only single-interest insurance. The purchaser, knowing that the finance company retains an interest in the car until it is paid for and has insured to protect itself, is at times left with the erroneous impression that his interest too is protected. On the other hand, if he knows that he has no protection, and does not realize that the finance company has covered the car for single-interest insurance, he may place independently the insurance he wishes. In such a case, if he has an accident, it occasionally develops that a clause is included in his policy stating that the policy is void if the article is insured by another company; the purchaser is thus

[36] A committee of the National Association of Insurance Commissioners, charged with investigating insurance problems arising in connection with automobile financing, reported to the Association in 1938 that a uniform automobile insurance policy was an urgent need. At least one state insurance department, Illinois, now recommends the use of uniform policy and certificate forms, samples of which it can supply.

[37] Federal Trade Commission, *op. cit.*, pp. 1055-57.

[38] *Ibid.*, p. 964.

unable to collect for his loss. Insurance departments find themselves in a difficult position in such cases but are often able to persuade the two companies involved to agree to a division of the loss.

Most of these insurance abuses are eliminated when there is a clear statement to the purchaser, informing him not only as to the exact cost of his insurance but also as to the insurance coverage which is provided him. Provisions regarding such a statement are contained in the codes of trade practices, the proposed uniform law and the consent decree stipulations concerning finance company registration. Also the Federal Trade Commission proposals for trade practice rules to apply to the entire automobile industry stipulate as an unfair trade practice "any false, misleading or deceptive statements or representations . . . concerning insurance rates and coverage," as well as any such misrepresentation concerning "rates of interest or plans respecting methods of financing, finance charges, endorsements, repurchase agreements, or transfers of installment sales contracts." Finally, the recent widespread activity of state insurance commissioners, requiring exposure of rates and coverage and stipulating proper practices in regard to finance insurance, has already effected considerable improvement in this range of problems.

Abuses in the form of fraudulent repossession procedures, exorbitant collection fees and deficiency judgments, the requirement of wage assignments as additional security, and similar coercive practices have existed mainly in the "gyp fringe" of the sales finance business, and have been condemned in practically all of the proposed regulations.

RECORD OF PURCHASER COMPLAINTS IN WISCONSIN

An interesting commentary on the sources of instalment financing abuses in the automobile trade is provided by

the record of purchaser complaints, January 1, 1936, to November 10, 1939, to the State Banking Department under the Wisconsin act regulating the sales financing of motor vehicles.[39]

Of a total of 1,043 complaints 59 percent were settled without a monetary adjustment; 38 percent entailed a monetary adjustment averaging $61 in the purchaser's favor, while only 3 percent remained without satisfactory settlement. Of the total dollar volume of adjustments made in the purchaser's behalf, over three-quarters was attributable to cases which the State Banking Department found to involve dealers' ethics, while less than one-quarter resulted from sales finance company practices.

According to the experience of the Division of Consumer Credit of the State Banking Department, "sales finance companies are always willing to make an adjustment if we can show that they have been in error on any complaint that has been filed with this Department; whereas, the motor vehicle dealers have not in all instances learned that the good will of the purchaser is of more benefit to them than the monetary consideration that they would have to give them in the form of an adjustment."[40]

[39] Data furnished by John F. Doyle, Supervisor of the Division of Consumer Credit, Wisconsin State Banking Department.
[40] Letter from John F. Doyle, November 13, 1939.

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[39] Data furnished by John F. Doyle, Supervisor of the Division of Consumer Credit, Wisconsin State Banking Department.

[40] Letter from John F. Doyle, November 13, 1939.

10

Income, Expenses, Profits

SINCE its beginning, in about 1915, the business of instalment financing has been a highly profitable one, with a very low rate of failure among the companies engaged in it. After a decade of operation, which included the downswing of the business cycle in 1920-21, it was said by a competent observer that the few failures which had occurred had been due principally to mismanagement or to legal defects in the sales agreements.[1] During the storm of business contraction from 1929 to 1933 no bank lost money from a finance company failure, although many finance companies lost money from bank failures. In fact, from the beginning there have been scarcely any finance company failures that resulted in serious loss to bank creditors, even though banks lend to these organizations much larger sums than they would to almost any other kind of business enterprise with the same net worth.[2]

Data available for a study of the income and expenses of sales finance companies are less complete than for certain other consumer credit agencies; therefore on this subject it is necessary to rely on information covering a relatively small number of companies. It is possible, however, to examine income and expense data of national, regional and local companies, and in addition to compare the profit rates of factory-controlled, factory-preferred and independent companies, figured on the basis of total capital employed in the business.

[1] G. W. Norris, address before the fourteenth annual meeting of the Chamber of Commerce of the United States, Washington, D. C., May 12, 1926.

[2] Milan V. Ayres, "The Economic Function of the Sales Finance Company" in *Time-Sales Financing*, vol. 3, no. 1 (January 1938) p. 4.

GROSS INCOME

The gross earnings of sales finance companies come from retail and wholesale financing, insurance placement, small loans, factoring (the discounting of various types of accounts receivable) and rediscounting the paper of other finance companies. It is not possible to generalize precisely regarding the relative importance of these various sources, but there is no doubt that retail financing, which constitutes from two-thirds to three-fourths of receivables outstanding, furnishes the bulk of gross earnings.

Wholesale financing, which constitutes 10 to 20 percent of receivables outstanding and a much higher proportion of volume (because of more rapid turnover than in retail business), accounts for scarcely more than 5 to 10 percent of gross income. Table 60 shows that for ten local sales finance companies, selected according to availability of data, income from wholesale financing averaged 5.5 percent of gross income in 1937, ranging from 3.2 to 11.7 percent; wholesale credit averaged 42 percent, however, of all credit extended. Wholesale financing is commonly transacted at the prevailing commercial interest rate, or even less, because the sales finance companies habitually accommodate dealers in this regard in order to share in the dealers' retail instalment paper.

Income from handling the insurance entailed in the retail financing of automobiles typically ranks after retail financing as a source of finance company earnings. It is considered in the trade as so important a source of income that one executive stated to an examiner for the Federal Trade Commission that the profit, in automobile financing, is in the insurance. Many finance companies own their own insurance companies and thus receive insurance profits directly; others have special arrangements with particular insurance companies. When the two types of business are independent the finance company receives a commission on the insurance busi-

TABLE 60

INCOME FROM WHOLESALE FINANCING OF 10 LOCAL SALES FINANCE COMPANIES IN PERCENT OF TOTAL GROSS INCOME, AND WHOLESALE CREDIT IN PERCENT OF TOTAL CREDIT EXTENDED, 1937[a]

Company[b]	*Wholesale Income in % of Total Gross Income*	*Wholesale Credit in % of Total Credit Extended*
A	5.0	48.2
B	3.9	26.7
C	6.9	40.9
D	4.4	49.0
E	11.7	51.3
F	6.1	40.0
G	3.2	36.7
H	7.8	52.9
I	3.2	25.3
J	5.1	35.9
AVERAGE	5.5	41.9

[a] Based on data obtained from the National Credit Office, Inc.; companies selected according to availability of data. Total gross income of the 10 companies in 1937 was $6,109,000, and total credit extended by them was $105,-470,000. For the few companies whose fiscal year did not end on December 31, 1937, the nearest fiscal year-end figures were used.

[b] Companies ranked according to volume of wholesale credit extended, with company of greatest volume designated as A.

ness it places, and according to the Federal Trade Commission this income has amounted to 30 to 50 percent of the retail insurance premium, sometimes more, depending on the loss record on business already placed by the finance company.[3] Available data covering ten local sales finance companies, presented in Table 61, show that in 1937 the insurance commissions of all ten companies averaged 7.3 percent of gross income; for the companies which had the highest percentages, however, commissions averaged almost twice this

[3] Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 926.

TABLE 61

INSURANCE COMMISSIONS RECEIVED BY 10 LOCAL SALES FINANCE COMPANIES, 1937, IN PERCENT OF TOTAL GROSS INCOME[a]

Company[b]	*Percent of Total Gross Income*
A	1.2
B	8.6
C	4.1
D	.1
E	18.4
F	10.9
G	21.3
H	2.2
I	15.7
J	10.7
AVERAGE	
10 companies	7.3
6 highest companies	13.6

[a] Based on data obtained from the National Credit Office, Inc.; companies selected according to availability of data. For one company the fiscal year ending June 30, 1937, was used.

[b] Companies ranked according to volume of retail automobile credit extended, with company of greatest volume designated as A; total volume of such credit extended by the 10 companies in 1937 was $54,444,000.

figure—13.6 percent. Wide variation is shown, the lowest percentage being 0.1 and the highest 21.3.

Gross income shows considerable variation according to the scope of a company's operations. Table 62 indicates that in the period 1928-39 gross income, in percent of year-end total assets, was lowest for nationals, and was lower for regionals than for locals. For the entire period it averaged about 11 percent for nationals, 13 for regionals and 15 for locals.

It does not necessarily follow from this comparison that the largest companies charged lower rates for financing, or that their *net* income was lower. It is a fact, however, that on the whole their charges were lower than those of companies

TABLE 62

GROSS INCOME OF SELECTED SALES FINANCE COMPANIES, 1928–39, IN PERCENT OF TOTAL ASSETS[a]

Year-End	*National Companies*	*Regional Companies*	*Local Companies*
1928	12.3	11.9	14.6
1929	12.4	13.4	17.0
1930	11.6	15.5	15.6
1931	11.2	11.8	17.1
1932	12.8	14.4	16.7
1933	11.5	12.1	14.1
1934	12.2	13.7	14.7
1935	11.1	13.1	13.9
1936	10.0	12.3	13.5
1937	10.4	12.0	12.9
1938	11.1	13.1	13.1
1939	9.5	10.4	12.0

[a] Based on data assembled by the Bureau of Business Research of the University of Illinois in connection with its study of *The Financial Policies and Practices of Automobile Companies* by H. W. Huegy and A. H. Winakor (Bulletin no. 56, 1938), and on data obtained from the National Credit Office, Inc. The number of companies included for each year was determined by the availability of data, and varied for nationals from 2 companies in 1928-29 to 3 in subsequent years, for regionals from 3 in 1928-30 and 4 in 1931-34 to 5 in subsequent years, and for locals from 7 in 1928 to 39 in 1937.

operating over less territory. Their smaller percentage of gross income is due mainly to the fact that they handle a larger proportion of low-profit types of paper. The national companies hold a larger proportion of new-car paper and a smaller proportion of used-car paper than do the locals (new-car contracts properly bear a lower finance charge than used-car contracts, which entail a greater risk). Also, whereas the regional and local companies have a relatively larger volume of retail automobile and small loan paper, the national companies handle more wholesale automobile paper and more factoring paper, which are low-rate, low-risk business.

EXPENSES

The three major categories of sales finance company expenses are operating expense, cost of borrowing and provision for taxes. Table 63 shows these categories for forty-seven sales finance companies in 1937, expressed in percent of year-end total assets and of gross income. It is evident that in relation to total assets the nationals had not only the lowest percentage of gross income but also the lowest percentage of total expense, 6.2 as against 8.1 for the regionals and 9.2 for the locals, although the regionals required less to meet the cost of borrowing, and the locals required less for taxes, than did the

TABLE 63

INCOME, EXPENSES AND PROFITS OF 47 SALES FINANCE COMPANIES, 1937, IN PERCENT OF TOTAL ASSETS AND OF GROSS INCOME[a]

Item	*National Companies*		*Regional Companies*		*Local Companies*	
	% of Total Assets	% of Gross Income	% of Total Assets	% of Gross Income	% of Total Assets	% of Gross Income
Gross income	10.4	100.0	12.0	100.0	12.9	100.0
Operating expense	3.6	34.4	5.8	45.4	6.4	48.9
Cost of borrowing	1.6	10.0	1.1	9.0	1.9	15.0
Provision for taxes	1.0	15.7	1.2	10.9	.9	7.3
Net profit	4.2	39.9	3.9	34.7	3.7	28.8
Total assets (year-end)	$1,470,484,000		$201,155,000		$164,255,000	
Gross income	$153,590,000		$24,227,000		$21,136,000	

[a] Based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market, and on Moody's *Manual of Investments*. National companies comprise General Motors Acceptance Corporation, Commercial Investment Trust Corporation and Commercial Credit Company; regionals comprise Associates Investment Company, National Bond and Investment Company, Pacific Finance Corporation of California, Bankers Commercial Corporation and Maytag Acceptance Corporation; local companies are a sample of 39 selected according to availability of data. For the few companies whose fiscal year did not end on December 31, 1937, the nearest fiscal year-end figures were used.

nationals. For regionals and locals over two-thirds of expenses were for operating outlays, for nationals a little less. Cost of borrowing absorbed about one-fourth of total expenses for the nationals, somewhat less for the locals and still less for the regionals, these differences arising partly from differing ratios of borrowed funds to equity funds. After meeting expenses the national companies had a larger proportion of gross income remaining for net profits than had either the regionals or locals, the percentages being 40, 35 and 29 respectively.

The trend of sales finance company expenses for the period 1928-39, expressed in percent of gross income, is indicated in Table 64. For all companies the proportion of gross income required for operating expenses and taxes increased considerably in 1930-32, thereafter declining irregularly; the later levels are substantially higher, however, than those obtaining in 1928-29, chiefly because of increased provision for taxes. During the difficult depression years the cost of borrowing, in relation to gross income, declined sharply for the national and regional companies, less conspicuously for the locals. This decline was due partly to the circumstance that the very low volume of business handled in those years decreased money costs in general. The fact that borrowing costs in relation to gross earnings were maintained at their lower level during the expansion years that followed reflects mainly the low interest charges on finance company borrowing.

The relatively high level at which all companies maintained their net profit in relation to income during the entire twelve-year period resulted in part from the fact that changes in operating expenses and taxes were compensated by changes in the cost of borrowing. It indicates too that the proportion of sales finance company expense which is in the form of overhead is comparatively small, while the corresponding proportion which is variable is relatively large. As a result of this distribution of costs, sales finance companies are able to

TABLE 64

EXPENSES AND PROFITS OF SELECTED SALES FINANCE COMPANIES, 1928–39, IN PERCENT OF GROSS INCOME[a]

Year	Operating Expense and Provision for Taxes: National Companies	Regional Companies	Local Companies	Cost of Borrowing: National Companies	Regional Companies	Local Companies	Net Profit: National Companies	Regional Companies	Local Companies
1928	47.8	49.5	51.2	29.5	21.5	21.8	22.7	29.0	27.0
1929	44.5	42.9	50.5	32.8	24.0	25.4	22.7	33.1	24.1
1930	47.2	46.5	54.9	25.2	20.5	25.7	27.6	33.0	19.4
1931	54.7	54.9	60.1	19.3	13.7	25.1	26.0	31.4	15.9
1932	58.6	67.9	61.7	19.8	16.7	23.7	21.6	15.4	14.6
1933	55.6	62.1	58.0	9.8	13.1	20.7	34.6	24.8	21.3
1934	51.2	57.9	56.8	8.8	9.8	19.5	40.0	32.3	23.7
1935	49.5	53.8	57.3	8.0	7.0	16.5	42.5	39.2	26.2
1936	51.0	56.0	56.7	9.0	7.0	14.8	40.0	37.0	28.4
1937	50.1	56.3	56.2	10.0	9.0	15.0	39.9	34.7	28.8
1938	54.5	56.8	59.9	10.4	6.2	11.4	35.1	37.0	28.7
1939	52.3	58.2	56.2	17.2	7.1	21.2	30.5	34.7	22.6

[a] Based on data assembled by the Bureau of Business Research of the University of Illinois in connection with its study of *The Financial Policies and Practices of Automobile Companies* by H. W. Huegy and A. H. Winakor (Bulletin no. 56, 1938), and on data obtained from the National Credit Office, Inc. The number of companies included for each year was determined by the availability of data, and varied for nationals from 2 companies in 1928-29 to 3 in subsequent years, for regionals from 2 in 1928-30 to 7 in 1936, and for locals from 8 in 1928 to 43 in 1936. Net profit is regarded as profit remaining after deduction for all expenses.

cut expenses promptly when business volume contracts, quite in contrast to businesses that are burdened with large overhead costs.

NET PROFITS

Table 63 showed that in 1937 net profit, in relation to total assets, was 4.2 percent for the national companies, 3.9 percent for the regionals and 3.7 for the locals. The comparative position of the three types of companies is much the same if net profit is regarded in relation to net worth (owners' invested capital), which is a more significant relationship in a consideration of a company's investment profitability. These percentages in 1937—for the same companies covered in Table 63—were 18.9 for the nationals, 14.6 for the regionals and 14.1 for the locals. This ranking reflects, of course, differences in the capital structures of the three types of companies—differences which were discussed in Chapter 2.

The relationship of net profit to net worth is shown in Table 65 for the period 1928-39, and these figures may be compared with those in Table 64 on the relationship of net profit to gross income during the same period. Both sets of figures are based on small and varying samples but they serve to corroborate other evidence: it can be seen from Table 65 that finance companies in general realize a high rate of return on invested capital, and that for the national companies the rate of return is generally higher than for the others; and Table 64 indicates that net profits represent a relatively high proportion of gross income, again usually higher—at least in recent years—for national than for regional or local companies. For all companies net profit in relation to net worth was lowest in the depression years 1932-33, and, especially for the nationals and regionals, has been highest since that period. Roughly the same trend is apparent in the relationship of net profit to gross income.

TABLE 65

NET PROFIT OF SELECTED SALES FINANCE COMPANIES, 1928–39, IN PERCENT OF NET WORTH[a]

Year	*National Companies*	*Regional Companies*	*Local Companies*
1928	14.6	12.3	12.5
1929	11.8	9.8	13.4
1930	11.9	8.4	9.8
1931	9.7	8.8	7.3
1932	6.1	3.8	4.2
1933	9.6	6.9	6.8
1934	14.6	11.6	9.5
1935	17.2	16.9	12.3
1936	19.5	16.0	13.7
1937	18.9	14.6	14.1
1938	14.2	16.2	7.9
1939	12.3	12.9	11.2

[a] Based on data assembled by the Bureau of Business Research of the University of Illinois in connection with its study of *The Financial Policies and Practices of Automobile Companies* by H. W. Huegy and A. H. Winakor (Bulletin no. 56, 1938), and on data obtained from the National Credit Office, Inc. The number of companies included for each year was determined by the availability of data, and varied for nationals from 2 companies in 1928-29 to 3 in subsequent years, for regionals from 2 in 1928 to 7 in 1936, and for locals from 11 in 1928 to 48 in 1936. Net profit is regarded as profit remaining after deduction for all expenses.

In view of the statement mentioned above that the profit in automobile financing is in the insurance, it would be interesting to examine the comparative significance of this item for many companies. There are but few companies, however, for which data are available. Among the ten local companies whose records were drawn upon in Table 61, income from insurance commissions in 1937 accounted for widely varying proportions of net profits, ranging from a low of 2 percent to a high of 89 percent; for all ten companies it averaged 23 percent, and for the six highest companies 54 percent.

It should be remembered, however, that in some cases insurance profits appear not on the books of the finance company itself but on the books of an affiliated insurance company.

In a consideration of the profitability of an entire business a profit rate computed, as above, in percent of net worth, or owners' invested capital, is a less significant figure than one computed in percent of total capital employed, including borrowed funds. The Federal Trade Commission has used the latter basis in its investigation of the motor vehicle industry, and its figures for five selected years in the period 1927-37 provide still further confirmation of the evidence already presented that sales finance company profits are relatively high and stable. The Commission's data, which have the special advantage of showing the comparative profit positions of independent, factory-preferred and factory-controlled companies, are presented in Table 66.

It is evident from this table that even in 1932, when the depression was at its worst, the average net profit on total capital employed was 6.5 percent for the independent companies, 5 for those that were factory-preferred and 5.9 for the company under factory control. In each year except 1927 the independents showed higher rates than either of the other types of companies; in recent years the factory-controlled company has shown the lowest rate, on this basis, although it was higher than either of the others in 1927 and was still a close second in 1932. It is interesting to observe that relatively few of the independent companies classified in this table had profit rates of less than 3 percent of total capital employed; in each year reported on, the greatest concentration of companies was in either the 6-9 or the 9-12 percent level.

Various factors help to account for the relatively high and relatively stable profit rates that have persisted among sales finance companies. Certainly one reason for the profit record

TABLE 66

CLASSIFICATION OF INDEPENDENT SALES FINANCE COMPANIES BY NET PROFIT IN PERCENT OF TOTAL CAPITAL EMPLOYED, AND AVERAGE NET PROFIT IN PERCENT OF TOTAL CAPITAL EMPLOYED FOR INDEPENDENT, FACTORY-PREFERRED AND FACTORY-CONTROLLED SALES FINANCE COMPANIES, SELECTED YEARS, 1927–37[a]

	1927	1932	1935	1936	1937
Net Profit		*Distribution of Independent Companies*			
Under 3%	3	3	..	1	1
3– 6	..	5	5	4	6
6– 9	2	7	9	12	15
9–12	6	3	10	7	4
Over 12	1	..	..	1	..
Total number of companies[b]	12	18	24	25	26
Type of Company			*Average Net Profit*		
Independent[c]	7.0%	6.5%	9.2%	9.4%	7.9%
Factory-preferred[d]	6.8	5.0	8.9	7.9	6.5
Factory-controlled[e]	7.7	5.9	7.0	5.7	5.6

[a] Based on Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 947.

[b] For some companies data were not available, or company was not in business, in years earlier than 1937.

[c] Same companies as those tabulated above.

[d] Includes Commercial Credit Company and Commercial Investment Trust Corporation (exclusive of Universal Credit Corporation) in all years, and Universal Credit Corporation in 1935, 1936 and 1937.

[e] General Motors Acceptance Corporation.

of this business is the fact that there has been for two decades an expanding market for sales financing services. Also, the nature of the business is such that in periods of cyclical decline in volume, operating expenses can be correspondingly adjusted, to a greater extent than is possible in many other fields. And the imperfectly competitive conditions that have characterized the business, in conjunction with the relative inelasticity of demand in periods of business recession, make it possible for companies to raise their charges in the face

of declining volume. Over the past few years low interest rates on borrowed funds have worked in favor of sales finance company earnings, and have helped to offset increased costs and increased business taxes and somewhat decreased finance charges.

Such explanations, however, are not in themselves sufficient. They do not touch upon certain important questions that are prompted by the profit record of the business. Why is it that such profits are not reduced by rate competition and by the entry of new capital into the field? Why is it that the business itself—standing so profitably between the ultimate source of funds and the retailer who finds the use for them—is not pressed into smaller and smaller scope by bankers and dealers, and even by those who offer alternative credit facilities to the consumer? These questions demand consideration of the peculiar competitive conditions that characterize the sales finance business.

11

Competitive Relations

THE competitive situation in the sales finance business is greatly complicated by the fact that manufacturer and dealer, as well as consumer, have an interest in the services rendered. Competition takes forms quite different from what might be expected if the transaction were effected directly between sales finance company and the purchaser of the commodity financed, with no other interests to be satisfied. The business is characterized by highly competitive practices, but many of these benefit the dealer rather than the consumer; all are potentially of interest to the manufacturer, but his affiliation with the sales finance process is itself a varying factor, and a further element in the competitive situation.

The importance of automobile financing in the business of sales finance companies justifies disproportionate attention to competitive relations in that field. This chapter, therefore, is concerned primarily with automobile financing, a more summary discussion sufficing in the field of diversified commodities. The competitive situation among sales finance companies will be analyzed as a problem with three different centers, as stressed above—consumer, manufacturer, dealer—and a final section will consider how the sales finance business as a whole is affected by the competition of other agencies of consumer instalment credit.

THE CONSUMER'S INTEREST AS A COMPETITIVE FACTOR IN AUTOMOBILE FINANCING

The aspects of a sales finance transaction which are, or might be expected to be, of interest to the consumer are primarily

the finance company's credit standards and procedures, its contract terms and finance charges, and the insurance coverage for the commodity purchased. In these matters practice varies among the different companies, and is susceptible to the pressures of competition.

It is not primarily the consumer, however, who has led the finance companies to compete with one another in regard to these aspects of the transaction. As a general rule the consumer is mainly interested in acquiring immediate possession of the commodity he is purchasing, and he seldom has either the knowledge or the inclination to explore the technical aspects of the transaction. Many consumers find it an embarrassing matter to go into debt for a purchase, and prefer to conduct their financing arrangements with a minimum of conversation; for others it is a matter of convenience to accept a suggested company without question rather than spend time shopping around for more advantageous arrangements. Moreover, as often as not the consumer is entirely ignorant of alternative sources of credit available to him, and even if he knows of them he is likely to be unable to estimate relative costs and merits.

In regard to the charges imposed by finance companies, it has already been mentioned that even a considerable change in rate results in only a slight percentage difference in total time price. It would appear that this fact has some bearing on the nature of demand for sales financing services. Experienced salesmen report that the consumer is typically more interested in the total time price, and the size of the monthly payments into which it is divided after he has made his down payment, than he is in the finance charge as such, and that he is not generally interested at all in the components of the finance charge. Especially to the higher-income instalment purchaser even an increase of 15 or 20 percent in finance charge may be seen not as an additional several dollars of financing expense but merely as an insignificant increase—

probably less than 1 percent—in the cost of his purchase, and as an insignificant addition—probably around 25 or 50 cents—to his monthly payment. And a decrease of such proportions may be similarly disregarded, since the total investment is already so large that a few dollars' saving is considered relatively immaterial. Such purchasers' unresponsiveness to price fluctuations undoubtedly reduces the incentive of sales finance companies to engage in finance charge competition, particularly in periods of business depression when lower-income purchasers, to whom even small economies are important, are relatively less numerous.

In this connection it is important to remember that in any one community there is but a small number of companies competing for the business, and that there are great disparities among them in financial strength and in geographical scope of operations—factors which also tend to decrease the free play of competition. Since sales finance companies obtain their business not directly from consumers but through the mediation of retail dealers, price competition is further restrained by the difficulties of making price changes known to consumers. There is indication, however, that conditions of competition are being modified, and the result may be that the consumer will become a more active element in determining price.

The inefficacy of consumers, as a group, in influencing the conditions of finance company competition should not be interpreted to mean that the consumer has in all respects had to accept whatever arrangements were offered him. In the first place, he is a highly important focus of competition among dealers. The purchase of an automobile, whether for cash or on instalment terms, contains many possibilities for bargaining, especially in regard to the trade-in value of an old car. To the individual consumer an automobile is usually an important purchase, to be undertaken with some care. The amount he is allowed for his old car is to him a big consid-

eration in determining where he will buy his new car, and therefore he shops around among dealers, and bargains with them, until he receives an offer that seems to him to involve no reflection on his business sense. This dickering is made possible by the inevitable lack of standardization in the value of used cars, and in this part of the transaction the dealer is at a disadvantage: he is not yet sure of his customer and, with other dealers competing with him, he knows that he has to make sometimes unwise compromises on trade-ins in order to close the all-important sale of another car.

To be sure, the dealer has several ways of compensating his frequent losses on trade-ins. In some cases he has been able to increase the price of the new car. In instalment transactions his various participations in the finance charges may also make up to him for any loss he has taken on the deal; these participations will be discussed presently, in relation to the dealer's role in finance company competition. But the fact remains that the lack of standardization in used-car values, and the consumer's natural inclination to take advantage of this situation, have a significant bearing on the conditions that prevail in automobile instalment financing. It is not possible to say how greatly these conditions would change if trade-in practices could be standardized, but certainly in that case at least one reason for high charges would be removed.

In instalment transactions the dealer may be pressed by the consumer into compromises also on other aspects of the deal, primarily down payment and length of contract, and here too he may jeopardize his own interests if he goes too far, for the finance company may require a full-recourse or repurchase arrangement on a contract whose terms are too far below standard. On charges he is less likely to compromise, for there he must make up the difference directly out of his own pocket, with no possibility of compensation elsewhere.

Even in regard to finance charges, however, the consumer, while not an essential focus of finance company competition,

has not been entirely without influence. The finance companies have had to consider the fact that a consumer who contemplates an instalment purchase, even if he does not typically show much concern about what is offered him, is certainly not wholly indifferent to the price of the transaction, and that if he regards it as out of reason he may insist on other financing facilities or even withdraw from the market. Moreover, advertising by consumer credit agencies, in which the national sales finance companies also engage, is making the consumer somewhat more aware of charges and contract terms. Finally, as will be discussed presently, the manufacturer has an interest in seeing that financing arrangements are kept sufficiently reasonable that he can count on instalment as well as cash purchasers for his cars. Thus the consumer, while not important as a direct incentive to competition in retail sales financing, has benefited somewhat from competitive action.

These benefits pertain mainly to finance charges and insurance, but the effects of competitive action in regard to these items will be discussed in relation to the manufacturer's participation in the process of sales financing.

THE MANUFACTURER'S INTEREST AS A COMPETITIVE FACTOR IN AUTOMOBILE FINANCING

To the manufacturer of automobiles instalment financing is an important instrument for selling his product: wholesale financing enables him to receive prompt payment from dealers, and thus conserve his own cash resources; and retail financing opens for him a wider consumer market. It is equally to his interest, however, that in the provision of the financing service no undue advantage be taken of the purchaser, for ill-will resulting from sharp practices is likely to be directed at him as well as the finance company, and financial difficulties of dealers hamper the distribution of his

product. This means that the manufacturer himself has an interest in seeing that a uniform financing plan is offered to his prospective purchasers, that charges are competitively low and standard, and that reasonable facilities are available to care for the wholesale financing of dealers. The following discussion of manufacturer relationships is based to a considerable extent on material in the Federal Trade Commission's report on the automobile industry.

The degree to which a manufacturer may participate in the retail and wholesale instalment financing of automobiles is at present an undecided question. In the past—in fact, until very recently—his relationship to the business has taken the form either of direct ownership of a finance company subsidiary to his factory, or of special arrangements entered into with a particular finance company. Today there is only one factory-controlled sales finance company engaged in financing retail and wholesale purchases of passenger automobiles—General Motors Acceptance Corporation, organized in 1919 and wholly owned by General Motors. In 1928 the Ford Motor Company formed Universal Credit Corporation for the purpose of financing the retail and wholesale purchase of Ford cars, and Ford officials declared that a specific intention in the formation of this organization was that it might serve as a yardstick for determining justifiable finance charges on the products of the parent company.[1] This finance company continued under Ford ownership until 1933; at that time, however, the majority of its voting stock was sold to Commercial Investment Trust Corporation, although it continued to concentrate on the financing of Ford products.

Until 1938 two finance companies were factory-preferred, that is, they operated under special agreements with various manufacturers: Commercial Credit Company; and Commercial Investment Trust Corporation, with its subsidiary, Universal Credit Corporation. The two factory-preferred com-

[1] Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 660.

panies and the one that is factory-controlled may be referred to jointly as factory-related. All three are national in scope; the regional and local companies have been for the most part independent, of wider or narrower range of operation.

The division of business between factory-related and independent companies is indicated in Table 67, for the year 1937. This table covers the total automobile instalment paper handled by 424 sales finance companies, these companies together accounting for more than 95 percent of all such paper handled by sales finance companies. Of the total volume of automobile paper handled in 1937 by these 424 companies, about 73 percent went to the three factory-related companies. Thus on the average each of these companies received about one-fourth of all automobile business handled by sales finance companies—twelve hundred times as much as the average for each of the 424 companies[2] and seven times as much as the average for each of the three regionals, which were the largest competitors of the factory-related companies. It is worth noting that the latter received a higher proportion of wholesale than of retail business—79 as compared with 68 percent of the total—whereas the other companies received less of the wholesale than of the retail paper, and in decreasing ratio with decreasing size of the companies.

In any particular locality, of course, the relative position of the various types of companies may have been quite different from that indicated in Table 67. In a given area two or fifty companies may have been competing for the available business—or there may have been only one, or even none. Thus it may be that within a certain territory a smaller company had a dominant position in the local market. But

[2] These 424 sales finance companies handled about 71 percent of all retail automobile financing in 1937, the other 29 percent going to an unknown number of other credit agencies (including a negligible few sales finance companies not reporting to the Department of Commerce). Of the total volume of such paper handled by all agencies in 1937, about 49 percent went to the factory-related companies, 8 to the regionals, 7 to the large locals and 8 to the small locals.

TABLE 67

PERCENTAGE DISTRIBUTION OF RETAIL AND WHOLESALE AUTOMOBILE INSTALMENT CREDIT EXTENDED BY SALES FINANCE COMPANIES, 1937, BY TYPE OF COMPANY, AND AVERAGE PERCENT RECEIVED BY EACH COMPANY[a]

Type of Company	*Retail Credit*		*Wholesale Credit*[b]		*Total Automobile Credit*			*Number of Companies*
	Percentage Distribution	Average % Received by Each Company	Percentage Distribution	Average % Received by Each Company	Percentage Distribution	Average % Received by Each Company	Volume (in millions of dollars)	
Factory-related	67.66	22.55	78.70	26.23	73.43	24.48	2,661.4	3
Regional	11.09	3.70	9.50	3.17	10.26	3.42	372.0	3
Large local[c]	9.44	.25	7.36	.19	8.35	.22	302.6	40
Other local	11.81	.03	4.44	.01	7.96	.02	288.6	378
ALL COMPANIES	100.00		100.00		100.00		3,624.6	424

[a] The dollar volume was $1,731,900,000 retail and $1,892,700,000 wholesale. Volume of 424 companies is the sum of the volume of 419 companies reporting to Department of Commerce, Bureau of the Census, plus that of 5 companies which did not report to the Department of Commerce. Volume of 46 companies in first three groups based on data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market; of these 46 companies, 41 reported information on volume to the Department of Commerce, and 5 did not. Volume for the 378 companies calculated by subtracting that of the 46 companies from that of the 424 companies.

[b] Principally wholesale financing of new cars, but includes some loans to dealers on stocks of used cars.

[c] Including two small regionals.

through the country as a whole there is no doubt that the greatest volume of business has been conducted by the factory-related companies.

The degree to which the facilities of the factory-related finance companies have been used by General Motors, Ford and Chrysler dealers is indicated in Table 68. It appears from these data that about half of General Motors, one-quarter of Ford and one-fifth of Chrysler dealers have used almost solely the facilities of their factories' respective finance companies. About one-eighth of General Motors, more than one-third of Ford and half of Chrysler dealers reported no use of the factory-related finance companies, or replied indefinitely.

TABLE 68

PERCENTAGE DISTRIBUTION OF GENERAL MOTORS, FORD AND CHRYSLER DEALERS, BY DEGREE TO WHICH THEY USED FACILITIES OF FACTORY-RELATED FINANCE COMPANIES[a]

Degree of Use of Factory-Related Finance Company	*General Motors Dealers*	*Ford Dealers*	*Chrysler Dealers*
Practically entirely	53	26	19
50–90 percent	23	16	17
Less than 50 percent	11	21	15
No use, or replies indefinite	13	37	49
TOTAL	100	100	100

[a] Based on Federal Trade Commission, *Report on Motor Vehicle Industry* (1939) p. 281. Number of dealers reporting not disclosed in the report, nor the dates to which these figures apply. In response to an inquiry the Federal Trade Commission has stated: "These percentages are based on replies received in response to a questionnaire sent to the automobile dealers in the fall of 1938. They cover whatever periods the various dealers have handled the products of General Motors, Ford or Chrysler. Some, therefore, may cover only a few months, possibly subsequent to the action of the Department of Justice against the three large finance companies, while others cover a number of years prior to that action." The factory-related finance companies are as follows: for General Motors, General Motors Acceptance Corporation; for Ford, Universal Credit Corporation; for Chrysler, Commercial Credit Company.

The special arrangements made by a manufacturer with a preferred finance company usually provided that the latter would finance the wholesale purchases of the factory's dealers and would offer retail purchasers an "approved plan" of financing, evolved by the manufacturer with the avowed purpose of providing relatively low-cost and uniform facilities for instalment credit. The manufacturer, in turn, endeavored to influence his dealers to use, and to recommend to their customers, the facilities of the preferred company. Thus the finance company benefited through increased business and the manufacturer benefited through the fact that his dealers and potential customers were offered what were regarded as attractive financing facilities.

It was customary, however, to supplement, or guarantee, these benefits by specific financial arrangements. Thus, under the various contracts between Chrysler Corporation and Commercial Credit Company, Chrysler agreed to pay the latter the difference between its aggregate automobile finance charges, at rates and terms prescribed by Chrysler, and the amount of finance charges that would otherwise have been in force. The finance company, in turn, agreed to pay Chrysler a portion of its profits. This resulted in payments by Chrysler in 1927 and 1928, totaling $1,474,000 for the two years, and in payments by the finance company to Chrysler in each year from 1929 through 1937, totaling $3,820,000 for the nine years and ranging from $39,000 in 1932 to $1,339,000 in 1937.[3]

Hudson Motor Car Company entered into contractual arrangements with Commercial Investment Trust, Inc., in 1922, under which the finance company was paid subsidies for the retail and wholesale financing of the cars of this manufacturer. From 1923 through 1932 the finance company received $1,471,000 in such payments.[4]

[3] Federal Trade Commission, *op. cit.*, p. 615.
[4] *Ibid.*, p. 688.

The Studebaker Corporation became interested in the financing requirements of its dealers as early as 1915, when it arranged for certain local banks to extend accommodations to Studebaker dealers in amounts totaling the amount of deposits made by Studebaker in the banks. In 1916 the Corporation arranged that Commercial Investment Trust, Inc., should extend credit to dealers, and agreed to absorb all losses from uncollectible accounts. Since 1919 Studebaker has had agreements with three finance companies, each at a different time, providing for wholesale and retail financing of purchases. No subsidies were paid, however, until 1923, when financing rates were set by Studebaker; payments were made each year from 1923 through 1932, totaling $5,728,000 and ranging from $44,000 in 1932 to $925,000 in 1925. After 1932 contractual arrangements with finance companies were continued but no subsidies were paid.[5]

Some indication of the effect of manufacturer efforts to keep charges low is contained in data presented in Chapter 8. It was shown there[6] that on both new cars and used cars the factory-related companies' finance charges were lower, in annual percentage rate, than those of the independents. Chapter 8 showed also that in 1936-38 the new-car charges of all types of companies (except the independents, on 24-month contracts) were substantially lower, in annual percentage rates, than they had been in 1935. This general decrease in the average rates on new cars was primarily the result of General Motors' announcement of the "6 percent" plan in the fall of 1935.[7] The plan reduced charges on new cars by 25 percent on 12-month contracts and 19 percent on

[5] *Ibid.*, pp. 817-18. Of the total amount paid out, $4,845,000 went to Industrial Finance Corporation (parent company of the Morris Plan system of industrial banking companies) and its subsidiary, Industrial Acceptance Corporation (1923-28); Motor Dealers Credit Corporation received $218,000 (1928-29); and Commercial Investment Trust, Inc., received $665,000 (1929-32).
[6] Chapter 8, Tables 55 and 56.
[7] See Chapter 8, pp. 201 ff.

18-month contracts,[8] and the other finance companies announced competing plans as quickly as they could be devised and publicized. It may be noteworthy that for the factory-preferred and independent companies the insurance percentages (insurance in percent of cash selling price and in percent of original unpaid balance plus insurance) were noticeably higher in 1936-38, at least on 12-month and 18-month contracts, than they had been in 1935, before the finance charge reduction. The possible inaccuracies in these insurance percentages should be borne in mind, however.

The Federal Trade Commission decision on the 6 percent plan has already been discussed. In its report on the automobile industry the Commission declared that this plan may be said to constitute one step "in what is possibly a vicious circle": the manufacturers built up their relations with finance companies partly in order to reduce the time-sales price of their cars; the discounts which the manufacturers allowed to dealers were considered by the latter to be inadequate; the dealers were therefore tempted to pack the finance charge to add to their profits; the factory-related finance companies sought to eliminate the packs; some dealers retaliated by switching their business to finance companies that would allow them to pack the finance charge; and finally with the 6 percent plan GMAC went directly to the public, as it were, hoping to educate consumers to compute finance charges for themselves and to compare them with alternatives, thus disclosing the packed charges and making it even more difficult for the independent companies to obtain additional business or retain what they already had.[9] The independent companies contended that if manufacturers had not discriminated against them, but had permitted the free play of competition among all finance companies, this competition would have

[8] Federal Trade Commission, *op. cit.*, pp. 972, 975.
[9] *Ibid.*, pp. 943-44.

reduced finance charges at least as much as they were reduced under the preferential system.[10]

The manufacturer's interest in the financing process has had some effect also on the charges for insurance. As has already been mentioned, the factory-controlled company, GMAC, places its insurance with the General Exchange Insurance Corporation—also owned by General Motors Corporation—and the rates it files with state insurance departments are lower than manual rates by about 25 percent, the difference being passed on to the purchaser.[11]

Many other sales finance companies own their own insurance companies—it has been estimated that at least 80 percent of the volume of premiums from retail financing now flows through wholly owned insurance companies—but the general practice is to quote only manual rates. Thus the other finance companies, where they wish to compete with GMAC on a price basis, must offset this disadvantage. Their markets overlap with GMAC's, however, only where they attempt to receive the business of General Motors dealers, for it is only the paper of these dealers that GMAC purchases.

The insurance "package" provided on different transactions varies considerably—some transactions carrying single-interest and others double-interest insurance, some carrying protection for collision and others not—and the various possible combinations result in decidedly different services. Where policies are issued to the purchaser the protection bought and the amount of the premium are ordinarily stated clearly. This may be done also when certificates are issued, but many finance companies using this method have not shown the insurance premium separate from the finance

[10] *Ibid.*, pp. 944-45.

[11] Late in September 1939 GMAC organized a special insurance company, the Motors Insurance Corporation, which is under the same management as General Exchange Insurance Corporation. This company does business at manual rates in California, Oregon and Washington, where state laws permit dealers to receive insurance commissions, but it is reported that where its facilities are used there is a corresponding reduction in finance charges.

charge, or stated the coverage in a clear fashion. This lack of uniformity has presented a problem for the companies which offered the most insurance protection per dollar of premium. The purchaser's ignorance has often worked to the disadvantage of the company offering him the best value.

The factory-related companies' affiliations with manufacturers have been strongly opposed by the independent companies as unfair competition,[12] on the ground that such organizational relationships operated to divert the flow of paper from them, not by providing superior service but by coercing and discriminating against dealers. The independent companies, through the medium of the American Finance Conference, contended that factory services, such as advertising of authorized finance plans and providing the aid of factory representatives in soliciting business for the affiliated companies, greatly reduced the latter's acquisition expenses, and were a powerful influence in diverting paper in their direction. In support of this position the American Finance Conference quoted a prospectus of Commercial Credit Company, issued June 16, 1937, in connection with a debenture note issue: "The services performed by Chrysler Corporation and its subsidiaries are believed to be a valuable advertisement of Commercial Credit Company and its business, plans and financing facilities, to save the Company a substantial sum in promoting and acquiring additional business from dealers, and to increase its business and profits."[13]

In its extreme form factory assistance was said to constitute dealer coercion by such methods as: "1. Refusal of independent finance company checks at the factory to cover wholesale loans to dealers when they take delivery of cars; 2. Delayed delivery of body types needed; 3. Forced delivery of other

[12] This and the following exposition of the independent finance companies' position is taken from "The Automobile Finance Business," a mimeographed monograph of the American Finance Conference, Chicago (July 15, 1937).
[13] *Ibid.*, pp. 4, 13.

types not wanted; 4. Delayed delivery of any type of car at time of introduction of new models; 5. Threat of cancellation of franchise; 6. Multiple dealer representation without economic justification; 7. Various and sundry dealer persecutions."[14]

The independents contended also[15] that the factory-related companies had access to funds at lower rates, that if the difference was not passed on to the public the result was higher profits, and that if it was passed on to the public the result was a reduction in rates "to the point where competition from independent finance companies disappears and a virtual monopoly without regulation ensues." The independents held that a borrowing position which was improved by factory affiliation was "nothing less than a case of indirect subsidy."

Through the American Finance Conference the independent companies brought these allegations to the attention of the Anti-Trust Division of the Department of Justice. In September 1937, after an investigation of the complaint, the Department instituted criminal proceedings in the Federal Court at Milwaukee against General Motors Corporation, Chrysler Corporation, Ford Motor Company, their associated finance companies and certain officials of the companies. In December the grand jury was dismissed on the ground that the government had been guilty of impropriety in holding discussions with representatives of the parties under investigation in order to arrange for a civil remedy in the form of consent decrees; these discussions had been held at the request of some of the parties concerned, and they were in conformance with the legal procedure provided in the Sherman Act. In May 1938 the Department instituted similar proceedings, this time in the United States District Court for the Northern District of Indiana. The grand jury re-

[14] *Ibid.*, p. 7.
[15] *Ibid.*, p. 20.

turned indictments against manufacturing companies, officials and finance companies on May 27, 1938.

The Ford Motor Company, the Chrysler Corporation and their associated finance companies were still willing to discuss consent decrees, and in order to provide a basis for them the Department of Justice instituted proceedings before the same court sitting in equity. As a result the government and the respondent companies consented to decrees which were issued November 15, 1938, effective March 15, 1939.[16] Meanwhile the contract between Chrysler Corporation and Commercial Credit Company had been canceled, the motor company's stock in the finance company had been sold, and it had been announced, in April 1938, that "Chrysler Corporation has no interest in and no contractual relations with any finance company." Similarly, it was announced, in December 1938, that Commercial Investment Trust Corporation had purchased the outstanding minority stock of Universal Credit Corporation, thus making the latter a wholly owned subsidiary of the former and divesting Ford Motor Company from any financial interest in the company.

General Motors Corporation refused to sign a consent decree and the case against that organization was prosecuted in the fall of 1939. A verdict of guilty was returned against the four corporate defendants (General Motors Corporation, General Motors Sales Corporation, General Motors Acceptance Corporation and General Motors Acceptance Corporation of Indiana) though the seventeen individual defendants —officers and agents of these corporations—were acquitted. The convicted corporate defendants, however, have filed notice of intention to appeal, thus leaving the issues of the case still pending.

The Department of Justice hoped to reach three objectives:

[16] U. S. *v.* Ford Motor Company, *et al.*, District Court of the United States for the Northern District of Indiana, Civil Number 8. U. S. *v.* Chrysler Corporation, *et al.*, District Court of the United States for the Northern District of Indiana, Civil Number 9.

the first was to eliminate any existing coercion of dealers by the manufacturers and their related finance companies intended to induce dealers to use the related companies; the second was to eliminate any manufacturer discrimination against independent finance companies by practices concerning wholesale financing (such as providing office space at the factory for representatives of the related company, or accepting payment directly from the related company for the cars it financed for the dealer, though not allowing the dealer this convenience in regard to the services of any other company); and the third was to eliminate from purchaser payments to dealers or finance companies any excess amount intended for bonuses or packs or for reserves which are actuarily larger than necessary to cover losses. This third objective cannot be achieved until the GMAC case is settled, but the first two were covered in the provisions of the consent decrees.

According to these provisions both manufacturer and finance company are to leave the dealer complete freedom to patronize any finance company he chooses. But although the manufacturer shall not recommend any specific finance company to his dealers or to the public, he can draw up his own new-car financing plans, recommend them to dealers, advertise them and arrange for one or more finance companies to make the plans available to the public. He is to accord equal treatment to all finance companies, though in regard to certain privileges hitherto reserved for the preferred company (such as office space at the factory, information concerning dealers, financing plans which give the finance company a competitive advantage through various manufacturer services or facilities) he is allowed to exclude "unregistered" companies.

A company that wishes to be regarded as "registered" is required to file with the court a statement, addressed to a particular manufacturer, agreeing to abide by certain regu-

lations in acquiring retail automobile instalment paper from that manufacturer's dealers. These regulations include provisions that the finance company, if it arranges for insurance, shall send to the purchaser, within 25 days after its acquisition of the contract, an insurance policy or certificate stating the coverage and the amount of premium; that it will not require or accept wage assignments or garnishments in collection of deficiency judgments on retail cars sold for less than $1000 unless it has requested the customer to surrender the car and he has not done so; that it shall take no deficiency judgment if the retail purchaser has paid at least 50 percent of his note; that its delinquency fees, its charges for extending or refinancing a contract, and its charges for collection or repossession shall conform with certain stated limitations; and that it shall not require dealers to take any collateral in addition to the car sold. As yet no finance company has registered.

The decrees signed by Chrysler and Ford and their related finance companies provide also that the manufacturer may not pay a subsidy to a finance company for the purpose of enabling or inducing it to offer his dealers lower finance charges unless he offers to pay similar subsidies to all finance companies offering the same finance charge, and finance companies are prohibited from paying money to a manufacturer in return for business acquired from his dealers. The manufacturer cannot lend money to or buy the securities of any finance company unless the outcome of the General Motors case is such that General Motors Corporation is not required to give up all ownership and control of GMAC.

If the prosecution of General Motors is ultimately successful the decrees will be subject to reconsideration, if the respondent companies request it, so that the requirements imposed on Chrysler, Ford and their preferred finance companies may be redrafted to conform with those imposed upon General Motors Corporation and GMAC. If the case against

General Motors is finally terminated with any result other than a judgment of conviction, all provisions of the consent decrees shall become inoperative.[17]

Thus the manufacturer's interest in the sales financing process is so strong that it has raised the question of anti-trust act violation. But this factory influence in the business, though it both contributes to and results from imperfect competition, is not to be taken as an explanation of high charges and above-average profits. On the contrary, the main reason for the manufacturer's interest has been his desire to see that consumers are granted attractive rates for the time purchase of his cars. His cooperation with the finance company for this purpose was made possible by his existent contractual relations with a large body of dealers—a group vital not only to his own but also to the finance companies' interests.

THE DEALER'S INTEREST AS A COMPETITIVE FACTOR IN AUTOMOBILE FINANCING

The importance of the retail dealer to the finance company derives from the fact that he is the one through whom it acquires its paper. The purchaser may occasionally make his own financing arrangements, or insist that the dealer finance his contract through a particular agency, but in the great majority of cases ignorance and inertia lead the consumer to accommodate himself to the finance plan offered by the dealer, whatever the agency with which it originated.

This strategic position of the dealer, which makes him, rather than the purchaser, the focus of finance company ef-

[17] It may be mentioned that the Federal Trade Commission's proposed trade practice rules for the automobile industry contain provisions stipulating it to be an unfair trade practice for any member of the industry to coerce another "to dispose of sales finance contracts to a specific finance company . . . or to specify or accept insurance through a specific insurance company, with the effect of thereby substantially lessening competition." Final action has not yet been taken on the Commission's proposals.

forts to obtain business, has led to many competitive practices which pertain only to him. Some of these practices—particularly the arrangements in regard to wholesale financing and in regard to responsibility for losses—have no direct bearing on the interests of the consumer; but other practices—particularly the arrangements concerning packs, reserves and bonuses—are directly reflected in what the consumer pays for the financing service.

The manufacturer demands cash for the cars shipped to his dealers, and many dealers, not being able to finance with their own capital the number of cars they need for display and stock purposes, meet the factory's requirements through wholesale loans. Sales finance companies extend them credit for 90 percent or more of the wholesale value of the cars.

When it finances the wholesale requirements of dealers the finance company ordinarily receives title to the car directly from the manufacturer, and a trust receipt, chattel mortgage or conditional sale contract from the dealer, who takes physical possession. If the same finance company finances also the retail instalment sale of the car, it retains title, under a new instrument, until the payments are completed. This is obviously the most convenient arrangement in regard to the amount of clerical work involved. Questions and paper work concerning title to the car are minimized, and payments on retail deals can be applied directly to liquidate wholesale loans. The independent companies' complaint that the dealer is not allowed this convenience except in dealings with factory-related companies has already been discussed, and also the provisions of the consent decrees which were intended to remedy the situation. On this type of business the most common charge made by finance companies during recent years has been a rate of 6 percent per annum. Early in 1939 a 4 percent rate was introduced, and at this charge the business is certainly unprofitable for many com-

panies, because the rates currently paid by finance companies themselves on their short-term borrowings range from $\frac{3}{4}$ percent, on paper sold in the open market, to as high as 8 percent for money borrowed directly from banks.[18] When losses and the expenses of handling the loans and taking periodical inventories of the cars are considered it is obvious that only those companies which are able to borrow at low rates can extend wholesale accommodations at 4 percent and not lose money. No company can be making much profit on the wholesale business and others must be taking it at a loss.

The importance of wholesale business is not in its profits, however, but in its serving as a lever for obtaining retail business from the dealer. It is a part of the total service the finance company extends in order to induce dealers to sell them retail contracts, which are profitable. The inducement may be the mere fact that it is more convenient for the dealer to do business with only one finance company, but as has already been indicated the dealer has sometimes been required—by manufacturer as well as finance company—to give the latter his retail business as a condition for receiving the favorable wholesale plan. The relatively low rate on wholesale financing is compensated by the relatively high rate on retail business. And since wholesale financing is a service extended on all cars, the instalment purchaser at present is paying, among other things, for a service extended to the dealer on cars eventually sold for cash.

Ordinarily an appreciable amount of the dealer's capital, which he could well use in other ways, is tied up in used cars. Many companies will make advances on these cars, pending their resale, but some frown on the practice. The used-car loan is in one sense the counterpart of new-car wholesale financing, but from the viewpoint of the lending agency there

[18] This is the range within which the bulk of the loans are made. In isolated instances lower and higher rates will be found. This information was compiled from data received from approximately 200 commercial banks widely distributed over the country.

is a good deal of difference between the two. The value of the collateral is much more difficult to ascertain in used-car than in new-car loans, and therefore greater risks are involved. This, along with the fact that the unit amounts involved are smaller, results in higher expenses than in new-car wholesale financing. If finance companies keep within the limits imposed by the usury laws the rates they can charge compared with the expenses involved make the business unattractive.

Used-car loans, like the wholesale financing of new cars, are principally a means of attracting the dealer's retail business. The companies not providing this service for the dealer have nothing with which to meet such competition directly, but they contend that the total service they extend is more advantageous to the dealer than the total service, including used-car financing, extended by their competitors.

In the early days of automobile instalment financing, before 1920, most of the paper was purchased with full recourse on the dealer in case of default. As an increasing proportion of his sales came to be made on the instalment basis this contingent liability became a continual threat to his solvency, and the finance company found itself in the position of protecting its own interests at the expense of its customers, the dealers, who were crying for relief. The result was the development of the repurchase plan about 1920.[19] This plan relieves the dealer of his recourse endorsement on the instalment contract but provides, through a general agreement covering all his relations with the finance company, that if repossession becomes necessary he will pay the balance of the purchaser's obligation, with, however, certain stipulated exceptions (referring mainly to cases of conversion, confiscation and collision). Later the non-recourse plan was developed by certain smaller companies which, in an effort

[19] See Chapter 4, p. 116. For a more detailed account of this development previous to 1927 see E. R. A. Seligman, *The Economics of Instalment Selling* (1927) vol. 1, pp. 75-81.

to obtain business, were willing to offer the dealer complete freedom from responsibility.

In regard to these dealer arrangements there is a clear, but by no means rigid, difference in policy between the larger and the smaller companies. The nationals usually purchase paper from dealers under the repurchase plan, but with the exception of GMAC they also buy some paper without recourse, one national company following one plan with some dealers and the other plan with other dealers. The regionals and locals conduct most of their business without recourse, but many of them buy a sizable percentage of their paper under repurchase agreements, and all of them buy some paper in this way. As a rule they buy the better-quality paper without recourse, and take the more questionable business on a repurchase arrangement. Data on 32 large locals show that in 1937, when they handled a retail automobile business of $123,587,000, these companies purchased 35 percent of their new-car paper and 45 percent of their used-car paper (40 percent of their total retail automobile paper) under recourse or repurchase agreements.[20]

The proponents of the repurchase agreement contend that the responsibility thus placed on the dealer causes him to be more discriminate in his selling of automobiles on the instalment plan, and that the result is a better credit situation than would exist if the paper were purchased on a non-recourse basis. The non-recourse companies, on the other hand, contend that they are close enough to the circumstances surrounding each deal to form an adequate judgment concerning the creditworthiness of the purchaser without the guarantee of the dealer.

Dealers selling their paper to repurchase and to non-recourse companies have not such a difference in losses as

[20] These figures include a small amount of paper classified as "partial recourse" by 10 companies. Data obtained from the National Credit Office, Inc., relating to companies using the commercial paper market; companies selected according to availability of data.

might be thought. The great majority of notes are collected without repossession, and on these no one loses. On the contracts of purchasers whose credit standing is doubtful from the beginning, even non-recourse companies typically require endorsement with recourse. As to the repossessions that do occur under repurchase agreements, there is often room for a difference of opinion in determining the extent of the dealer's stipulated exemption, and this difference must be settled by administrative decision of the finance company's representative after discussion with the dealer. It is frequently advisable to favor the dealer in such decisions, and if this is done he does not pay as much as a strict interpretation of the agreement would require. Thus, at least in relatively prosperous times, the two methods of purchasing paper have not, in themselves, very different effects; in times of depression, when the repossession ratio is higher, a greater difference may be expected.

The development of these plans has been accompanied, however, by practices which constitute a highly important aspect of sales finance company competition for dealer business and which have a direct bearing on the interests of the consumer, and therefore of the manufacturer. These are the payments made to dealers in the form of reserves, bonuses and packs.

In the middle 1920's companies purchasing paper with full recourse endorsements or under repurchase agreements introduced the dealer's reserve in order to protect the dealer against losses arising from repossessions and thus meet the growing competition of companies offering non-recourse plans. An amount equaling a certain percentage of the customer's original unpaid balance, regarded as part of the finance charge, was set aside as a reserve for the dealer, to be used in cases of repossession loss; when this reserve exceeded an agreed-upon percentage of the outstanding amount of his notes held by the finance company, he was paid the

difference. The non-recourse companies were now at a disadvantage and countered by offering dealers a bonus for their business. The bonus also was computed on the original unpaid balance, and included in the finance charge. Both the reserve and the bonus provided a source of income to dealers, and some provided themselves with further income by arbitrarily increasing the finance charge; this additional amount, the "pack," was paid by the customer as part of his debt, and given the dealer by the finance company.

The resultant situation is clearly unsatisfactory for the finance companies as well as for the consumer, but, as was indicated in Chapter 9, attempts to remedy it have met with little success, at least partly because the problem of dealer payments is closely connected with the larger problem of manufacturer affiliation with the sales finance process. Most of the non-recourse business has been conducted by independent companies, using this plan of operation as a competitive device against companies that have received factory help in acquiring dealers' paper. The independent companies have contended that the dealer's reserve allowed by the larger companies is greatly in excess of the amount needed to cover actual losses, and that therefore they too are justified in allowing the dealer a special benefit, in the form of the bonus. They also maintain that if it were not for this inducement dealers would sell their lower-risk paper to the companies offering repurchase plans and would sell only higher-risk paper to the non-recourse companies.

Toleration of the pack has also been justified as a competitive necessity, but if this is the case the practice appears to have defeated its own ends, for packing is permitted by practically all companies. And even where the dealer is not permitted to pack the finance charge he has sometimes achieved about the same result by packing the cash selling price, a procedure over which the finance company has no control. This latter practice has recently been made difficult,

however, by factory requirements that the dealer stipulate to the customer all the component items in the price of his car.

Data on these various payments, classified according to the companies' factory relationships and expressed in percent of total insurance and finance charges, were presented in Chapter 8. It was shown there[21] that in 1936-38, according to the samples collected by the Federal Trade Commission, the packs allowed by factory-preferred companies took, on the whole, a larger fraction of total charges than did those allowed by the other companies. For all companies approximately one-tenth of the average insurance and finance charge on new cars—and a somewhat larger fraction on used cars—went to dealers for reserve or bonus.

It is not possible to determine with any accuracy whether the amounts allowed for dealer loss reserves are indeed excessive, for cyclical and geographical variations make this an extremely complicated problem. The Federal Trade Commission attempted an analysis of the question[22] but was unable to obtain sufficient information for reliable results. In the end it felt justified in stating only that "there is a certain amount of evidence that the amounts allowed as dealer's loss reserves do exceed somewhat the average loss ratio."

If in all cases the reserve were exactly sufficient to cover losses incurred by dealers which they would not have incurred under the non-recourse plan, its effect would be simply to equalize the attractiveness of the two types of plans in the eyes of the dealer. In so far as the reserve is greater than this it is, like the bonus and the pack, a subsidy or commission paid to the dealer for his business.

There is no doubt that the amounts of these increments vary considerably as between different finance companies, and even as between different transactions. And apparently

[21] Chapter 8, Table 54.
[22] Federal Trade Commission, *op. cit.*, pp. 938-40.

one reason for this variation is that some finance companies, in their competition for dealers' business, have relied more on factory relationships than on these special financial arrangements. But in any case, all these increments are paid by the purchaser of the car, through increased finance charges. It is possible that in cases involving a trade-in the dealer passes on to the customer at least a part of his bonus, reserve or pack, in the form of a larger trade-in allowance than he would have extended had he not expected to receive a part of the finance charge on the deal. It is difficult, however, to ascertain whether this has been done in any particular transaction, for individual used cars have no standard trade-in price. Moreover, a large trade-in allowance, granted the customer as a special inducement, may be the cause rather than the result, of a dealer's pack.

As has been mentioned, the Department of Justice hopes to eliminate all payments that are of the nature of a subsidy, and limit the dealer's reserve to an amount no larger than necessary to cover actual losses. But in the meantime these dealer payments have become entrenched as a highly important aspect of sales finance company competition, and as a problem with a direct bearing on the interests of the consumer.

COMPETITIVE RELATIONS IN DIVERSIFIED FINANCING

In diversified financing, too, the manufacturer's interest has an important effect on competitive relations. Since this field is so extensive and so miscellaneous far more manufacturers are involved, though none of them conducts a business so large as that of any of the "big three" in automobiles. Some manufacturers have close relations with preferred finance companies, but much more often than in automobile financ-

ing the manufacturer has his own financing subsidiary or department.

Again the independent companies complain that the manufacturers coerce dealers to give their business to the related finance companies, that they discriminate against the independents in favor of the related companies, and that they are sometimes more liberal with terms and charges than they would be if they were not interested in the manufacturing profit to be made by extending the market for their goods. It is contended, for example, that electric power companies, in their desire to increase their power loads, extend overliberal terms in financing the purchase of electric appliances, and are able to absorb their repossession losses by charging them against the profits from their total business instead of against the profits from the financing business alone.

Government agencies (Electric Home and Farm Authority and Federal Housing Administration) have also had an influence on the competitive situation in diversified financing. The competitive importance of FHA, in its insurance of financial institutions against losses on certain types of loans, has been mainly in the fact that it has encouraged banks to enter the field of diversified sales financing. EHFA, which is specifically in the sales finance business, has served to focus attention on the question of terms, for its charges are lower and its contract terms are on the whole more liberal than those characteristically made by private agencies in the same field.

In diversified financing there has not been such a widespread standardization of contract terms as has developed in regard to automobiles, and therefore low down payments and long contracts are of more importance as competitive devices than they are in automobile financing. The dealers who can offer financing facilities under the more liberal contract terms have obviously a significant sales advantage.

Diversified financing is typically conducted on a recourse

basis, and dealers' reserves are in common use. Sometimes, however, especially in regard to refrigerator paper, dealer recourse is limited to the period of four or six instalment payments, though with various stipulated exceptions. Packs are allowed by some companies, though the practice is generally frowned on.

The purchaser has ordinarily been required by the terms of the contract to assume the risk of loss from fire, theft and other special causes. If insurance is required it has been placed in some instances by the dealer, in others by the finance company and in others by the purchaser himself, the cost being separate from the finance charge. EHFA, however, and also, since 1939, certain of the national sales finance companies that conduct diversified financing provide insurance themselves, without special charge to the customer. If this practice proves to be an effective competitive measure other companies may have to follow suit, but in general insurance has not been such an important consideration in diversified as in automobile financing.

COMPETITIVE RELATIONS WITH OTHER CONSUMER CREDIT AGENCIES

This summary description suggests answers, though necessarily complex ones, to the question why competition among sales finance companies has not developed in such a way as to bring about a lower level of charges, and ultimately of profits. Not so complex is the further question as to why other credit agencies have not attempted to share in the profits of the sales finance business.

The answer is that to a considerable extent this is now happening. In recent years sales finance companies have met increasing competition from other consumer credit agencies, both in the form of new institutions entering the sales financing field itself and in the form of new rivalry from alterna-

tive methods of consumer instalment financing. Commercial banks and industrial banking companies have actively sought not only to obtain a larger share of the retail dealer's financing business but also to reach the prospective commodity purchaser directly, thus entirely eliminating the dealer's role in the credit transaction. This latter form of competition inheres also in the activities of personal finance companies, which make cash loans direct to consumers. How acutely the sales finance business feels this competition of other consumer credit agencies is difficult to say; inter-agency competition is reportedly keen today in some regions and potentially it is keen in all. It does not appear to have resulted in an absolute decline of sales finance company business, but there is some basis for inferring that the sales finance companies' relative share of the consumer credit market has suffered somewhat of a contraction.

In acquiring retail instalment business some banks concentrate their efforts on the consumer, and others consider it more desirable to establish contacts with dealers. The latter method of acquisition is likely to result in a quicker development of volume, but the building up of direct consumer relationships is believed by some bankers to make for a more secure basis of business.

When banks attempt to reach the consumer directly the sales finance companies can meet their competition only as they meet that of direct cash lenders—by going directly to the consumer, that is, by advertising. One or the other competitor may experiment with a reduction in rates, and it may be because of this competitive situation between banks and sales finance companies that a somewhat lower level of charges has prevailed in recent years, though it is not possible to say whether the decrease is the result of bank or of finance company leadership.

When the dealer is the focus of the banks' efforts to obtain business there are several ways in which the finance com-

panies attempt to maintain their position. The loss reserve, the bonus or other finance charge participation allowed the dealer is of course a strong competitive weapon, and one of the most customary ways in which the finance company attempts to meet the bank's competition is by offering the dealer a more substantial participation. Also, the finance company may emphasize its willingness to take all the reasonable paper offered by a dealer, thus capitalizing on the fact that some banks are willing to finance only the best-quality notes. The finance company's willingness to accept a dealer's wholesale paper is a strong talking point in some cases, for not all banks will extend the dealer this service.

Finally, the handling of insurance may serve as a useful competitive weapon. Since the sales finance company, in contrast to the bank, usually places all insurance with the same company it can emphasize to its dealers its ability to divert repair business in their direction. In the states on the west coast, however, it is possible for the bank, which is prevented by law from acting as an insurance agent, to arrange for the dealer to participate in the commission on insurance, and in automobile financing this may be a serious threat to the sales finance company's customary procedure and even to its competitive position. In this connection it is interesting to note the report that Motors Insurance Corporation allows the dealer a commission on the insurance he writes; this is the new company which GMAC organized late in 1939 and which now conducts business at manual rates on the Pacific coast, where dealers may be licensed as agents, and where bank competition is especially keen.

A more difficult type of competition for the sales finance company to meet is the direct cash loan to a prospective commodity purchaser. This kind of instalment credit is extended mainly by the personal loan departments of commercial banks, by industrial banking companies and by personal finance companies. Sales finance companies have recently at-

tempted to counteract the loan promotion activities of cash lenders by means of national advertising and circulars to customers affirming the superiority of sales finance company services over those of other credit sources.

The strategic position of the dealer in the extension of retail instalment credit has already been abundantly emphasized. All competing sales finance agencies receive at least some of their paper—usually most or all of it—direct from the dealer, and therefore, as has been shown, competitive practices are likely to center around him more than around the consumer. But frequently the dealer enters the field himself, and to the extent that he does this he becomes a formidable competitor of all the competitors. In automobile retailing, the high unit value of the good prevents dealers from any extensive financing of their own instalment paper; probably no more than 10 percent at the outside is carried by dealer capital. In other retail fields, however, such as furniture, household appliances and equipment, jewelry and "soft" goods, dealer capital may finance a large proportion of instalment sales. There is no doubt that the high profits which have characterized consumer financing are an incentive to the dealer to provide his customers with this service without resort to an outside agency.

Against this form of competition the various agencies of sales finance credit can do little, but though their share of the market may be curtailed by some of the larger retailers, it is not likely that their function will be replaced. For they have all the advantages of specialization: greater capital resources available for a specific purpose; an organization geared to the procedures required; and, especially important, a valuable store of experience in regard to the intricate problems of contract terms and finance charges. The extent to which the sales finance company excels its institutional competitors in these respects is probably the best indication of the extent to which it will withstand their rivalry.

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